RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE SIMPLIFICATION ACT OF 1981

HEARINGS

BEFORE THE

SUBCOMMITTEE ON LABOR

OF THE

COMMITTEE ON
LABOR AND HUMAN RESOURCES
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

S. 1541

TO AMEND THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 AND THE INTERNAL REVENUE CODE OF 1954 TO CONSOLIDATE AND SIMPLIFY THE ADMINISTRATION OF THE PROVISIONS OF LAW RELATING TO RETIREMENT INCOME ARRANGEMENTS, TO PROVIDE FOR INCENTIVES FOR PENSION PLAN COVERAGE AND INCREASED RETIREMENT SAVINGS, AND FOR OTHER PURPOSES
AND RELATED BILLS

NOVEMBER 4, 9, AND 12, 1981, AND JANUARY 26, 1982

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RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE SIMPLIFICATION ACT OF 1981

WEDNESDAY, NOVEMBER 4, 1981

U.S. SENATE,
COMMITTEE ON LABOR AND HUMAN RESOURCES,
SUBCOMMITTEE ON LABOR,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:13 a.m., in room 4232, Dirksen Senate Office Building, Senator Don Nickles (chairman of the subcommittee) presiding.

Present: Senators Nickles, Hatch, and Williams.

OPENING STATEMENT OF SENATOR NICKLES

Senator NICKLES. Good morning.

Today is the first of 4 days of hearings on Senate bill 1541, a bill which would amend the Employee Retirement Income Security Act, commonly known as ERISA. Today and next Monday will be devoted to the first five titles of the bill, which amend the first three titles of the act. Fiduciary responsibility will not be discussed until January 26, 1982, when we will conclude these hearings. One week from today, we will focus on title VI of the bill, which is title IV of ERISA—Plan Termination Insurance.

I believe if there is ever a time to amend the Retirement Act, it is now. As the social security trust fund faces financial crisis and as Americans' personal savings continue to dwindle as a percentage of spendable income, more attention must be focused on private pensions to meet the needs of retiring Americans.

Independent research indicates that the present laws have led to a reduction in the number of pension plans being created today, and have actually increased the number of plans that have folded. The burdensome reporting and disclosure requirements which were developed in 1974 ERISA laws have contributed heavily to today's pension plan problems.

About 3 weeks ago, the GAO issued a report saying that many of the required filings cannot be found in the Labor Department's files. It is ludicrous to continue a law which defeats the very purpose for which it was established and which mandates unnecessary and burdensome paperwork.

The Reagan administration supports the elimination of bureaucratic redtape, and I do not know of one business that would oppose such an effort. Senate bill 1541 simplifies current reporting and disclosure requirements, while protecting the rights of participants and beneficiaries to have access to all information regarding their retirement funds.

The bill further simplifies the process for employers to provide retirement income to employees by consolidating the functions of the Labor and Treasury Departments and the Pension Benefit Guaranty Corporation.

The purpose of a new, consolidated Employee Benefit Administration is to eliminate employer frustrations. Currently, employers get one opinion from the Treasury and one from Labor and, as a result, spend money on complicated administration instead of using it to fund pensions. I look forward to hearing testimony on this consolidation.

The bill also provides incentives for employers to provide pension benefits to employees. These include payroll deductions for independent retirement accounts—the so-called IRA's—in companies without pension plans, and directions for the Labor and Treasury Departments to study the feasibility of master and prototype plans to ease the burdens on small employers.

Only 26 percent of the employees at businesses with fewer than 25 workers are now eligible for company pensions. We must create an environment conducive to the establishment of more pension plans so that more workers can retire with an income from a private pension system.

While I am opposed to the Federal Government imposing mandatory pension plan requirements on American businesses, I believe that through proper and frugal administration, the Nation's businesses will desire the opportunity to provide this benefit to employees.

Senate bill 1541 is an ambitious step—one that will not be possible without the help and cooperation of all affected groups. There is no alternative to American reliance on private pension plans. I believe that, together, we must enact legislation to place them prominently in the American lifestyle.

Senate bill 1541, as introduced, is a very complicated, long bill; it is, I think, 300-and-some pages. I have never stated that I believe it is perfect, but I believe it is a good step in the right direction for us to have hearings and to receive input and cooperation from all concerned, to see if we cannot come up with very good changes in the original 1974 act to have our pension systems and the pension systems for all Americans on a more sound and more actuarially-sound basis for all Americans to depend on for their retirement income.

We will now receive, for the record, a statement from Senator Hatch.

[The prepared statement of Senator Hatch follows:]

PREPARED STATEMENT OF SENATOR HATCH

Senator HATCH. Mr. Chairman, I cannot say how pleased I am that you have initiated hearings on the ominibus ERISA reform legislation (S. 1541). ERISA is, without a doubt, the most complex, technical legislation governing labor relations today. Moreover, the countless days of hearings and the literally thousands of pages of testimony which the Labor Committees have received over the last 7 years have vividly demonstrated that ERISA is burdened with problems. The need to address these problems becomes more acute as time goes on. Our population is becoming older and more reliant upon private pensions. The private pension system is becoming the custodian and trustee of more and more of our Nation's wealth. Consequently, we must see to it that the laws governing and structuring the private pension system promote efficiency, secure equity, and above all protect the interests of the working man and woman.

I believe S. 1541 goes a long way in attempting to rectify the problems which the public and the Government have encountered with the 1974 act. The bill was not put together overnight. It is the product of many hundreds of hours of thought, discussion, and tedious drafting. I think Senator Nickles must be given a tremendous amount of credit for undertaking, so early in his Senate career, the monumental task of reforming ERISA.

I hope that all interest groups—from industry, from the administration, and from labor—appreciate the commitment which the Senator, and indeed this committee, are making in this area. I hope that we can count on the support from all these sectors in solving the problems of ERISA.

[The test of S. 1541 follows:]

Senator NICKLES. Our first guest this morning is Senator Slade Gorton from the great state of Washington.

Senator Gorton, we welcome you and appreciate your input in this area. Do you have some comments?

STATEMENT OF HON. SLADE GORTON, A U.S. SENATOR FROM THE STATE OF WASHINGTON

Senator GORTON. Thank you, Mr. Chairman.

It is obviously a pleasure to appear before this subcommittee to join you in your review of the Employee Retirement Income Security Act of 1974. ERISA, along with the Multiemployer Pension Plan Amendments Act of 1980, fundamentally changed the nature of private pension plans and the legal and regulatory environment in which they must function.

This legislation attempted to remedy real problems which had developed in the area of private pensions. Unfortunately, there have been significant negative side effects which have actually discouraged both the formation and continuation of private pension plans.

This is a matter of concern because I believe that private pensions must provide a major share of the retirement income that our aging population will require. Indeed, the long-run solvency of the social security system will become a less desperate question in direct proportion to the growth of private retirement plans.

During last summer, in response to numerous inquiries from small business men and women, the Small Business Subcommittee on Productivity and Competition, which I chair, held a hearing on the problems ERISA has created for small business. I would like to share with you today some of the findings of that hearing.

ERISA, as amended, has resulted in: one, a dramatic increase in the administrative costs of maintaining private retirement programs; two, a change in the nature of new plans away from defined benefit programs to defined contribution plans; three, a significant reduction in the flexibility employers have in designing plans to meet employee requirements; four, plan sponsors have been subjected to long, expensive delays due to a cumbersome regulatory process; and, five, the creation of "new" liabilities for the unfunded benefits of existing plans has adversely affected the salability of many small businesses and the creditworthiness of many others.

S. 1541, the Retirement Income Incentives and Administrative Simplification Act of 1981, contains proposals to deal with many of these problems. These proposals provide a good basis to begin the search for appropriate remedies. I believe the solutions to these problems must be found if we are to restore to health our private retirement system.

But I also believe that these solutions must be fair to all involved—employers, employees, and the general public. The only way to insure this is to have open and frank discussion of all of the issues.

Your hearing today on S. 1541 provides exactly that opportunity. For this reason, I am pleased to join with you, Mr. Chairman, as a cosponsor of this bill. S. 1541 may not represent the entire answer, but it certainly represents a constructive start and provides the basis from which the discussion may begin.

Senator NICKLES. Thank you, Senator Gorton. I very much appreciate your comments, and also your cosponsoring this particular piece of legislation. I think it is important to all of our States, and particularly to our small businesses.

You alluded to the small business area that you have had some input and some instruction on. If we do not make some changes in the existing law under ERISA, do you believe that there can be a resurgence of pension plan formation among small businesses?

Senator GORTON. I do not think that will happen among small businesses, as the term is normally defined. The problem is that it costs just about the same amount to form a pension plan covering 100 employees as it does for a plan covering 10, but the per-employee cost, of course, is one-tenth as much for that larger plan.

As a consequence, there have been very few new pension plans formed for small businesses with, say, 25 employees or fewer, and that represents the great majority of all small business firms. This is the area in which pension plans are probably the most absent in the first place.

So, unless we simplify and unless we cut down on these administrative costs, that vast number of small businesses and new businesses simply are going to stay out of the pension system entirely.

Senator NICKLES. That is a good comment. The biggest void is probably in the small businesses, and that is also where the biggest or most dramatic area of growth is that we will see in new job opportunities at the same time.

Senator GORTON. And also the areas which are most penalized by the present law.

Senator NICKLES. Good comment.

In your testimony, you mentioned several problems which ERISA created for small businesses that did offer pension plans. Which of these problems do you consider possibly the most damaging to small business?

Senator GORTON. That is a difficult question to answer because there are so many of them, but we did identify a number in our hearing. One of the most significant and the kind of thing that gives the Government a bad name is that many of the current reporting and disclosure requirements seem almost to be useless.

An example is the ERISA annual report. No funds have ever been appropriated to allow those reports to be processed. So, here is a cost imposed on every system for a report which is literally useless because it cannot be organized in a way in which people can find it.

Next—and this was one that was the subject of quite a bit of adverse testimony at our hearing—the prohibited transaction section, I am convinced, needs to be amended so that legitimate transactions are no longer either prohibited or delayed for so long that they are in effect prohibited.

The current law is obviously too restrictive. One businessman who testified before us from Seattle stated that his firm's pension plan had been prohibited from investing in the firm's real estate, even though that investment was very, very secure, and had been required to invest in approved bonds.

Well, of course, what has happened there and in many other businesses across the country is that real estate has gone way up in value in that period of time. The bonds, of course, due to the rise in interest rates, dropped far below their nominal value. And the only group which is penalized, and penalized very heavily, are the employee beneficiaries of that plan.

Senator NICKLES. Just to interrupt, the very intent of the law, which was to provide security of investments and to protect employees, is actually working to their detriment because they were not able to invest in what 20-20 hindsight has proven to be a profitable investment, and were actually pushed into one that has actually turned out to be nonprofitable.

Senator GORTON. That is exactly right. You know, we just do not have 20-20 foresight in Congress, and when we tell organizations what they can invest in and what they cannot invest in, we are very, very likely to be wrong, and obviously we were in this case.

Even beyond that is simply the time which the bureaucracy requires to process matters. We heard from one businessman in Seattle who had been waiting 6 years for a ruling on a question of this nature. Now, of course, the very fact that he came to our hearing and complained about it enabled us to zero in on that specific complaint—suddenly, he got an answer. But for every individual who gets to a Member of Congress or a Member of the Senate and gets some kind of relief, of course, there are probably dozens and maybe hundreds who have not been able to handle it in that fashion.

In this area, as in many others, justice delayed is justice denied.

Another area which is a very troubling one because answers do not come easily to it has to do with the financial requirements and with the unfunded liability requirements in business fields which are rapidly changing.

We heard, I think, more anguished testimony from a number of people in the trucking business than from any other. The combination of these laws and of the substantial deregulation of trucking has put many established businesses with union contracts and what would be good pension systems at a tremendous disadvantage compared to new companies coming into the field which do not provide pension systems at all.

The costs of competition between two such companies in a deregulated area are so disproportionately great that we may see, partly as a result of this act, a number of bankruptcies or insolvencies on the part of significant businesses which have been in existence for an extended period of time.

Senator **Nickles**. I appreciate your comments and your support of this legislation, and as we continue receiving input and the possibility of changes, we will keep you advised. Hopefully, we will be able to work together for a good bill to alleviate many of the problems which you have mentioned.

Senator **Gorton**. Mr. Chairman, may I do one other thing? I have a statement here from a close friend, Dallas Salisbury, who runs the Employee Benefit Research Institute here in Washington, D.C., which I would appreciate being included in the record.

Senator **Nickles**. We will be happy to include that into the record.

Senator Gorton, thank you very much.

[The prepared statements of Senator Gorton and Mr. Salisbury follow:]

THE HONORABLE SLADE GORTON
NOVEMBER 4, 1981
SUBCOMMITTEE ON LABOR

EMPLOYEE RETIREMENT INCOME SECURITY ACT

Mr. Chairman, it is a pleasure to appear before this Subcommittee today to join you in your review of the Employee Retirement Income Security Act of 1974. ERISA, along with the Multiemployer Pension Plan Amendments Act of 1980, fundamentally changed the nature of private pension plans and the legal and regulatory environment in which they must function.

This legislation attempted to remedy real problems that had developed in the area of private pensions. Unfortunately, there have been significant negative side effects that have actually discouraged both the formation and continuation of private pension plans. This concerns me because I believe that private pensions must provide a major share of the retirement income that our aging population will require. Indeed the long-run solvency of the Social Security system will become less a question in direct proportion to the growth of private retirement plans.

This past summer, in response to numerous inquiries from small businessmen and women, the Small Business Subcommittee on Productivity and Competition, which I chair, held a hearing on the problems ERISA has created for small business. I would like to share with you today some of the findings from this hearing.

ERISA, as amended has resulted in:

** A dramatic increase in the administrative costs of maintaining private retirement programs;

- ** A change in the nature of new plans away from defined benefit programs to defined contribution plans;
- ** A significant reduction in the flexibility employers have in designing plans to meet employee requirements;
- ** Plan sponsors have been subjected to long, expensive delays due to a cumbersome regulatory process;
- ** The creation of "new" liabilities for the unfunded benefits of existing plans has adversely affected the salability of many small business and the credit worthiness of others.

S. 1541, the Retirement Income Incentives and Administrative Simplification Act of 1981 contains proposals to deal with many of these problems. These proposals provide a good basis to begin the search for appropriate remedies. I believe that solutions to these problems must be found if we are to restore to health our private retirement system. But I also believe that these solutions must be fair to all that are involved. The only way to insure this is to have an open and frank discussion of the issues.

The hearing today on S. 1541 provides this opportunity. For this reason, I am pleased to join with you, Mr. Chairman, as a cosponsor of this bill. S. 1541 may not represent the entire answer, but it certainly is a constructive start and provides the basis for the discussion to begin.

STATEMENT
OF
DALLAS L. SALISBURY
SUBMITTED TO THE
UNITED STATES SENATE LABOR COMMITTEE
SUBCOMMITTEE ON LABOR
FOR THE RECORD OF IT'S HEARING OF
NOVEMBER 4, 1981
ON
S. 1541

Any opinions stated in this testimony are Mr. Salisbury's.

INTRODUCTION

Providing for retirement income in the United States has taken on economic dimensions foreseen by very few as recently as 1974. The long-term costs of meeting retirement income promises already made is staggering:

- o several trillion dollars for Social Security;
- o nearly one-trillion dollars for federal employees;
- o billions for state and local employees;
- o billions for private-sector employees;

Meeting these costs could prove to be the major policy issue in the retirement income area in the decade ahead. How it is answered will be of tremendous importance to all those involved - which means every American.

For example, were the decision made to expand benefit provisions through Social Security and to raise payroll taxes to a level sufficient to meet all Social Security obligations, the demand for private plans and the dollars available to fund private plans would decrease.

In addition, extant research indicates that Social Security contributions at best have no effect on aggregate savings levels while private pension contributions increase aggregate savings by between 35¢ and 80¢ per contributed dollar. Clearly indicating that a shift from private pensions to Social Security could have a negative effect on savings and capital markets.

ERISA AND PRIVATE PENSIONS

The Employee Retirement Income Security Act of 1974 (ERISA) has a formative history that goes back at least to 1955. While the reaction to jobs lost through the closing of the U.S. Studebaker auto plant was one of regret, reaction to the fact that some accrued pension benefits would not be paid was met with shock and anger. With the Studebaker closing, the movement for "reform" began in earnest, culminating in the passage of ERISA.

COVERAGE AND PARTICIPATION

ERISA established age 25, one year of service and 1,000 hours of work as the required minimum standard for pension plan participation. Adjusting for agricultural and self-employed persons this "ERISA" workforce represents 49.7 million workers, out of a total workforce of 95.4 million. Employer plans cover 74% of the ERISA workforce: 68.3% actively participate. Of participants who had 10 or more years of service in current jobs, 78% were vested and another 11.4% did not know their vesting status.

Mature industries have even higher levels of coverage. In 1979 relevant workforce coverage in the Mining industry was 88.8%, in Manufacturing 81.9%, and in Transportation 79.9%. If only private establishments with 1,000 or more employees are considered, in 1979 the coverage rate was 95.8%.

And, contrary to reports, private pension plan growth has not stopped. In 1950 9.8 million participated in plans, by 1979, 35.2 million participated: participation growth of 263%, compared to labor force growth of 89% During 1980 new plan qualifications included 3.8 million participants and from January 1, 1981 to June 30, 1981 an additional 2.3 million participants.

In spite of adverse experience immediately following passage of ERISA, net plan formation since 1974 totaled 197,523 plans. In 1976 there were only 3,494 net new plans; in 1980, 56,063. During the first half of 1981, 31,478 new plans were formed.

Those not covered by a private plan can be clearly identified:

- o 31% of workers report that they are working for firms with less than 100 workers, yet they represent 67.1% of the noncovered;

- o Trade and Service employees generate 38.7% of jobs, they represent 58.4% of the noncovered;

- o 27.7% have annual earnings below $10,000, they represent 44.1% of the noncovered;

- o 42.3% have been with their current employer for five years or less, but constitute 57.9% of the noncovered.

The noncovered work in newer industries, for small employers, for shorter time periods and at relatively low wages.

The noncovered represent 23% of the ERISA workforce. Present policies plus individual provisions will provide retirement income to many of these persons by the time they reach age 65. Research undertaken in 1980 by the President's Commission on Pension Policy and reformulated in 1981 for EBRI indicates that 70% to 80% of those reaching 65 at the turn of the century will receive private pension income. For others, particularly those with limited workforce attachment, government transfer programs may be the only effective means of providing "retirement" income.

ASSETS

Pension funds held assets of $687 billion at the end of the second quarter of 1981, ($478.4 billion private; $208.6 billion state and local). These funds grew from 5% to 16% of total financial assets from 1950 to 1980. In 1979, the top 25 corporate funds held $120 billion; the top 25 public funds held $126-130 billion; the top 25 Taft-Hartley funds held $12 billion. Private assets grew 35-fold from 1950 to 1980 (13.25% per year), state and local assets grew 40-fold (13.8% per year) with a net inflow for private funds in 1980 of $22.3 billion.

The U.S. Department of Labor and the U.S. General Accounting Office have both made estimates of future asset levels - assuming no changes in public policy. These forecasts project total assets of $3 trillion in private plans and $975 billion in state and local plans by the mid-1990's.

Major public policy changes may well be made in the Social Security program which could have a dramatic effect on these future asset projections.

INTERACTION WITH SOCIAL SECURITY

Any of the following changes in Social Security could have important consequences for private and public employer plan contribution levels, asset accumulations and individual initiatives:

- raising retirement ages
- reducing the level of indexing
- adjusting the benefit calculation formula
- speeding up increases in the payroll tax
- universal coverage

Public and private employer pensions and individual effort are playing an increasingly important role. The continued level of effort will be affected by future Social Security policy, future policy on in-kind benefit programs, and future federal regulatory policy. Given these facts the need for national attention to retirement income policy on a comprehensive basis cannot be stated too strongly.

WHY ERISA?

ERISA specified the following problems that required legislative solution (Act Section 2):

1. lack of employee information;
2. due to the lack of vesting provisions many employees with long years of employment were losing anticipated benefits;
3. due to the inadequacy of minimum funding standards, the soundness and stability of plans with respect to adequate funds to pay promised benefits might be endangered;
4. due to the termination of plans, employees have been deprived of anticipated benefits.

These problems led to articulation of specific policy:

1. Require reporting and disclosure ... establish fiduciary standards ... require vesting of accrued benefits of employees with significant periods of service ... establish minimum standards of funding ... and require plan termination insurance.
2. encourage the continuation and maintenance of voluntary private pension plans and the timely and uninterrupted payment of pension benefits.

The Act also allows for the undertaking of research and surveys to collect, compile, analyze and publish data, information, and statistics relating to employer benefit plans.

The Departments of Treasury and Labor and the Pension Benefit Guaranty Corporation have worked continuously since the passage of ERISA to responsibly meet their obligations.

While there are many who feel that revision and refinement of ERISA is both needed and justified, few if any deny that ERISA was needed or advocate its repeal.

POST-ERISA EXPERIENCE

Experience since September 2, 1974 has been documented and analyzed thoroughly enough to allow an assessment of ERISA provisions. In fact, in some cases that analysis has been so complete that it has already led to major post-ERISA legislative changes in the plan termination insurance program. While the "market place" appears to have adjusted to the presence of ERISA, there is substantial evidence indicating that there are many changes that could be made to reduce plan costs without reducing the protections and safeguards provided by ERISA.

Further, such reforms could be expected to accelerate the rate of new plan formation and growth of participation that has been experienced since 1977; could remove the conditions that have caused no new multiemployer plans to be created; and, could remove special pressures on defined benefit plans.

Table 1 provides detail on plan and participation growth since 1976.

TABLE 1

PLAN QUALIFICATIONS AND PARTICIPANTS FOR SELECTED YEARS

YEAR	STOCK BONUS		MONEY PURCHASE		PROFIT SHARING		TRASOP/ESOP		TOTAL DEFINED CONTRIBUTION		DEFINED BENEFIT		TOTAL	
	PLANS	PARTICIPATION	PLANS	PARTICIPATION	PLANS	PARTICIPATION	PLANS	PARTICIPATION	PLANS	PARTICIPATION	PLANS	PARTICIPATION	PLANS	PARTICIPATION
1976 Number 1/	738	275,803	6,206	42,082	11,129	217,525	85	244,488	18,891	780,708	2,595	134,462	21,486	915,170
Percent	3.5	30.1	28.9	4.6	51.8	23.8	.4	26.7	87.9	85.3	12.1	14.7		
1977 Number 2/	856	1,436,358	10,113	133,968	17,099	479,910	132	1,264,515	28,463	3,315,205	6,953	1,639,719	35,416	4,954,924
Percent	2.4	29.0	28.6	2.7	48.3	10.0	0.4	25.5	80.4	66.9	19.6	33.1		
1978 Number 3/	850	1,255,173	21,821	202,995	32,890	1,089,934	196	206,237	55,956	2,754,635	9,728	1,125,498	65,684	3,880,133
Percent	1.3	32.4	33.2	5.2	50.1	28.1	0.3	5.3	85.2	71.0	14.8	29.0		
1979 Number 4/	574	362,263	15,969	146,150	24,239	369,000	286	173,112	41,122	1,050,595	15,755	972,062	56,877	2,022,657
Percent	1.0	17.9	28.1	7.2	42.6	18.2	0.5	8.6	72.3	51.9	27.7	48.1		
1980 Number 5/	492	1,043,655	19,706	193,133	30,251	742,041	51	18,454	50,493	1,997,285	18,849	1,784,280	69,342	3,781,565
Percent	0.7	27.6	28.4	5.1	43.6	19.6	0.1	0.5	72.8	52.8	27.2	47.2		
1/1 - 6/30														
1981 Number	190	180,469	7,802	155,953	12,032	225,261	52	19,294	20,076	580,977	11,402	1,717,075	31,478	2,298,052
Percent	0.6	7.9	24.8	6.8	38.2	9.8	0.2	0.8	63.8	25.3	36.3	74.7		

1/ 733 Bond Purchase Plans with 810 participants not shown separately.
2/ 263 Bond Purchase Plans with 454 participants not shown separately.
3/ 199 Bond Purchase Plans with 296 participants not shown separately.
4/ 54 Bond Purchase Plans with 70 participants not shown separately.
5/ 3 Bond Purchase Plans with 4 participants not shown separately.

Source: EBRI Tabulations of IRS Data.

ADMINISTRATION

The TRIPARTITE agency administrative structure found in ERISA, based upon the legislative history, was quite clearly the result of political compromise. As a result of its initial inefficiences the agencies agreed to a reallocation of responsibilities in 1976 and the Reorganization Plan Number 4 of 1979 made these adjustments permanent.

The review, conducted by the Office of Management and Budget in developing the Reorganization Plan, clearly indicated that substantial cost savings could be realized through consolidation into a single agency. The review also indicated that arguments for the current structure principally centered around the need to assure that multiple interests would be considered on major issues. The present structure, it is argued, provides that assurance.

IRAs AND DEDUCTIBLE CONTRIBUTIONS

The legislation (S 1541) being discussed today highlights the importance of working towards a holistic national retirement income policy. Such a policy would generally be viewed as including an emphasis on individual effort in addition to government or employer sponsored programs.

Up through this year, 48 million persons were elegible for IRAs, with 5.3 million persons creating them. They are principally created by persons over age 25, working full time and earning more than $20,000. This group accounted for 4.4 million of all IRAs. Of the 5.8 million persons meeting these criteria and with more than one year of service, 75.9% created IRAs. With the extension of IRA elegibility to all workers, 25 of the 49 million new eligibles represent good IRA prospects in that they match the above criteria.

If 25% to 50% of these persons were to establish IRAs, the potential annual retirement income set aside could be as high as 20 billion dollars.

See Table 2.

IRAs have been criticized in the past for not providing for low income individuals. Available research indicates that this is true. IRAs generally provide for the moderate-income, full-time worker; they cannot be expected, based upon available information, to provide for low-income individuals. The government program safety net promises protection to low-income individuals with sporadic attachment to the workforce. IRAs will increase the number of persons with adequate income during retirement, but will not eliminate poverty among the elderly.

Corporate experience with thrift-savings plans and payroll deductions lends evidence that deductible employee contributions will be used. Many companies have achieved up to 80% utilization across all income groups. And, a recent survey indicated that over 50% of all workers will set aside additional dollars if given the ability to do so on a tax deferred basis.

These new approaches and opportunities can greatly enhance retirement income and move us towards more comprehensive ways of supplementing Social Security.

REPORTING AND DISCLOSURE

Reporting and disclosure requirements of ERISA have been among its most frequently criticized provisions. And, as a result, among the most analyzed.

A 1977 Department of Labor sponsored study indicated that small employer plan administrative costs were increased by as much as 100% by ERISA requirements.

TABLE 2

FACTORS AFFECTING IRA CREATION

FACTOR	NUMBER ELIGIBLE (MILLIONS)	NUMBER IRAs (MILLIONS)	UTILIZATION
INCOME LEVEL			
< $20,000	31.0	0.9	2.9%
> $20,000	18.0	4.4	24.4%
$20-$50,000	16.4	3.5	21.3%
> $50,000	1.6	0.8	50.0%
AGE			
25-64	25.0	5.3	21.2%
> $20,000	9.2	4.4	47.8%
Service and Hours[1/]			
25-64	15.0	5.3	35.3%
> $20,000	5.8	4.4	75.9%

Source: EBRI estimates from May 1979 CPS Data and Treasury Department Data, 1979.

A 1978 study conducted by Arthur Andersen & Company indicated that for a sample of 48 large employers the added administrative costs approximated 9 million dollars. Extrapolation indicates that for all plans the added costs could approximate 100 million dollars.

Three purposes were set forth in ERISA for the reporting and disclosure provisions:

1. to provide information to the government for purposes of enforcement;

2. to provide information for research studies called for in ERISA section 503; and

3. to provide information to plan participants and beneficiaries.

The common complaint in past hearings has been that no research has been presented to document or quantify the benefits achieved as a result of the above noted costs, or how effectively the noted purposes have been achieved. Our limited review indicates that:

1. Due to the agencies' enforcement focus on large plans and the lack of effectiveness with which the documents filed have been handled, there may be more information required than will be or can be effectively used.

2. Funding for finishing 1978 and 1979 statistical files was cut off in mid-1980 and the data will not be available for research studies. As a result, this reason for collecting certain information is removed. Many argue that if research is not to be done, the information now required to be filed might instead be required to be available upon demand.

3. There is no documented evidence showing that plan participants and beneficiaries make use of the information provided to them. Instead, there is a clear consensus that they discard the information in most cases. Again, many argue that access to much of the information on demand might meet the objectives of ERISA more efficiently.

To summarize, there is agreement that the purposes of ERISA are sound, but that the implementation might be made more efficient and effective.

MINIMUM STANDARDS

Research on the effects of the participation, vesting and funding provisions of ERISA has been quite extensive. Government and private-sector research indicates that:

1. The minimum standards set forth caused an increase in plan costs, a reallocation of plan benefits to shorter service workers, and a general strengthening of plan funding status.

2. Principal difficulties identified have been related more to the complexity of regulations than to requirements of the statute. For example, there are multiple definitions being promulgated for hour of service and year of service and IRS/Treasury initiatives regarding vesting (the 4/40 controversy).

3. Studies indicate that earlier participation or faster vesting would increase costs from 2% to 30% without any significant increase in benefits provided and an actual long term decrease in benefits provided to long-service workers.

To summarize, the statutory minimum standards of ERISA are generally viewed as both constructive and sufficient. There is, however, a documented concern over regulations that have been issued in the past.

FIDUCIARY STANDARDS AND PROHIBITED TRANSACTIONS

This area of ERISA represents one of the most important and controversial. For plan sponsors, concern has principally been over the time and expense that has been required to obtain exemptions from the agencies and the inability to continue what have been normal business practices that are viewed as legitimate. For fiduciaries, concern has principally been over the greater stringency of ERISA provisions as compared to the fiduciary requirements in other areas of activity. For investment specialists there has been concern that ERISA has discouraged venture capital investment. And, for a very diverse group there is a belief that these requirements have eliminated creativity in the investment of pension assets.

Research in this area has been limited. Articles, speeches and past testimony represent the only real resources. These resources:

1. highlight the fact that these provisions will become increasingly controversial as the size of pension assets continues to grow and multiple interests seek to move investments to their benefit;

2. provide example after example of transactions that require exemptions that the authors find it nearly impossible to view as abusive;

3. provide substanial evidence that the cases brought to date by the government would not have been harmed by less restrictive fiduciary and prohibited transactions provisions;

4. indicate that these provisions increase the cost of plans due to the necessity of constant legal review of even the smallest transaction by the plan and its fiduciaries.

To summarize, the fiduciary and prohibited transactions provisions of ERISA are shown by available information to have stopped certain bad practices while creating added plan costs and placing a special burden on many good practices. The same information indicates that there are ways to open up an easier path for the good without condoning the bad.

FUTURE PROSPECTS

Private sector reaction to the post-ERISA environment shows the tremendous resilience of our economic system. In spite of the new costs and administrative requirements of ERISA, private plan formation has nearly reached its pre-ERISA levels. New participation is growing rapidly, and there is every reason to believe that the market will respond to new incentives. In this case, a reduction in the costs of creating and maintaining a pension plan could provide such an incentive.

With the difficulties facing the Social Security system, the need for a complementary private employee benefit system has never been more clear.

Senator **Nickles**. Our next witness today is Congressman John Erlenborn from the State of Illinois. Congressman Erlenborn has an extensive background in the ERISA field; he has been a leader on the House side for this type of legislation, and has introduced a companion bill.

Congressman, again I welcome you before our subcommittee, and we very much appreciate your interest in this legislation, and also your expertise in this legislation. Likewise, we look forward to working with you for a good bill in both Houses to where we can hopefully enact some legislation to alleviate many of the problems that have been addressed.

Welcome.

STATEMENT OF HON. JOHN N. ERLENBORN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. **Erlenborn**. Thank you, Mr. Chairman.

Mr. Chairman, in my opinion our national pension system is at a crossroads. It is my belief that S. 1541, the Retirement Income Incentives and Administrative Simplification Act of 1981, sets forth the necessary blueprint for building on the strengths and correcting the weaknesses of our present system of providing retirement income.

Senator Nickles, you and the other sponsors of S. 1541—Senator Hatch and Senator Wallop—are to be congratulated for taking the lead role in the Senate in giving recognition to the need for the establishment of a rational retirement income policy. You can be assured of strong support and cooperation toward the early enactment of this legislation next year from myself and my colleagues in the House who have authored the identical measures, H.R. 4330 and H.R. 4334.

Various demographic and economic forces and the stifling effects of the Employee Retirement Income Security Act present a challenge to the means of providing retirement income in the eighties and beyond.

The ERISA is well-intentioned, but flawed. Most recently, ERISA's shortcomings were brought to the attention of Vice President Bush's Task Force on Regulatory Relief. ERISA was quickly placed on the list of regulations dubbed the "Terrible 20"—the 20 having been determined to be the most burdensome and costly. For too long, ERISA has been the subject of derision, inasmuch as the acronym has come to stand for "Every Ridiculous Idea Since Adam."

The sentiment, as expressed in the reports of the many retirement income study groups, is that to expand participation, we need new pension plans, and to enhance retirement income, we need new retirement savings. This is the framework around which the omnibus ERISA legislative program embodied in S. 1541 and H.R. 4330 is structured.

The key to the successful implementation of a rational retirement income policy is the consolidation of Federal pension regulation under a single agency, to be known as the Employee Benefit Administration, or EBA.

If the principal objective of ERISA—namely, assuring that workers receive entitled benefits—is to be fully realized, a single agency must administer the law. Toward this end, the charter given the EBA is to "foster the orderly growth and maintenance of employee benefit plans."

The EBA would be headed by a full-time, three-member board of directors consisting of a liaison officer from both the Labor and Treasury Departments and the Executive Director of the EBA, who would serve as chairman.

The PBGC would retain its present corporate character within the EBA, with the membership of the EBA and PBGC board of directors being identical to prevent any future conflict in EBA and PBGC policies or operations.

By also serving as the Executive Director, the EBA chairman of the board would be able to implement the policies set by the board both efficiently and expeditiously. The representation on the board of the Department of Labor and the Department of Treasury by their liaison officers provides assurance that pertinent labor law and tax law policies will be given due consideration.

The ERISA functions of the Secretaries of Labor and the Treasury would be transferred to EBA, as would the functions of all other agencies and departments relating to employee benefit plans, subject to the discretion of the President.

All regulations and rulings previously issued by the Treasury, IRS, Labor and PBGC would remain in effect. Any other Federal agency or department issuing regulations affecting employee benefit plans would be required to consult with the EBA to avoid duplication and inconsistency.

The functions and duties of the Treasury Secretary transferred under the bill are those under titles I, II and IV of ERISA, and those under other provisions of the Internal Revenue Code which relate to the formulation of retirement income policy or to plan qualification and disqualification.

The enforcement functions under both title I and title II of ERISA would be transferred to the EBA. As a result, the enforcement remedies under title II—for example, plan disqualification, excise taxes and other penalties—would be exercised solely by the EBA in a coordinated fashion with other civil remedies under title I of ERISA. The conflicting or duplicative enforcement activities under present law would be eliminated.

The consolidation of ERISA administration under the EBA would simplify ERISA, end waste and duplication, and create a new positive regulatory climate in which sponsors will be encouraged to establish new plans and expand existing ones.

The other titles of the ERISA simplification legislation build on this theme of expanding private pensions by instilling into the body of the law a new measure of certainty for plan sponsors. The litigious aspects of ERISA are reduced, and the resulting savings in legal and other administrative costs can be translated into benefit improvements for participants.

First, the bill provides that a State insurance law which requires that a specific benefit be provided or made available by a contract or policy of insurance issued to an employee benefit plan is preempted and is not saved under the existing insurance exception.

The proposal is intended to overrule the decision in *Wadsworth* against *Whaland*, in which the first circuit held that ERISA did not preempt a State insurance statute requiring insurers to provide coverage in group health insurance policies for treatment of certain illnesses and disorders. If left uncorrected, *Wadsworth* would permit indirect State regulation of employee benefit plans and would encourage plans to avoid such regulation through self-insurance.

In addition, the bill amends the preemption section to make it a matter of Federal law that benefits provided under an ERISA-covered pension plan may not be assigned or alienated. The purpose of the one exception to this rule is to reserve for the States their traditional control over marital and family matters and to aid plan administrators who are faced with the conflicting duties of obeying State court decrees to pay benefits to plan participants' former spouses and also of complying with the existing antialienation rule under penalty of plan disqualification.

The bill also clarifies the original intent of Congress in passing ERISA by restating in a positive fashion the areas of State and Federal securities laws which are inapplicable in connection with an employee's interest in an employee benefit plan.

Firstly, a participant's interest in an employee benefit plan covered under ERISA is not to be considered a security or similar right for purposes of the acts administered by the Securities and Exchange Commission. Secondly, ERISA preempts any provision of State law which defines or treats such a participant's interest in an employee benefit plan as a security or similar right.

A more certain regulatory atmosphere is also created by codifying the elapsed time rule and by clarifying that ERISA's ban on exculpatory provisions is not intended to prevent indemnification of fiduciaries by parties related to a plan.

The fiduciary provisions of ERISA have come under the most intense criticism for having created excessive burdens and uncertainty. To correct this situation, the bill seeks to simplify and clarify some of the concepts relating to the assignment and allocation of fiduciary duties. The bill modifies, as well, the provisions dealing with the general subject of cofiduciary liability in an attempt to perfect the language consistent with the policy of ERISA.

Also, the bill replaces the draconian prohibited transaction standards under section 406(a) with the more workable standards originally adopted by the House of Representatives when the House considered the ERISA legislation in 1974.

In addition to the general prudence and exclusive benefit requirements under section 404, the 406(a) standards require plan transactions with parties-in-interest to meet tests involving adequate consideration, adequate security, and reasonable rates of interest which are not inconsistent with the fiduciary requirements under section 404.

Cases involving the more egregious and pervasive violation of ERISA's fiduciary standards transcend mere 406(a) violations, and the bill will provide a more effective enforcement mechanism for dealing with such cases by consolidating all enforcement remedies under ERISA and the Internal Revenue Code within the Employee Benefit Administration.

Until all enforcement responsibilities can be consolidated under the Employee Benefit Administration, the bill allocates the prohibited transaction enforcement responsibilities relating to pension benefit plans to the Department of Labor, which has already been allocated most of the authority to issue exemptions pursuant to the President's Reorganization Plan No. 4.

The current 5-percent and 100-percent excise tax penalties under the Internal Revenue Code would be replaced by discretionary 5 percent and 100 percent civil penalties under section 502(d) of ERISA.

Turning to another area of current concern to many plan sponsors, the bill contains a provision to clarify Congressional intent in connection with the nondiscrimination rules under the Internal Revenue Code section 411(d)(1).

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After a close study of the GAO report, I am sure there will be changes in addition to those already in the bill that can be agreed on to make ERISA more manageable in the reporting and disclosure area.

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A key element in the development of a rational retirement income policy is the degree to which qualified pension plans can integrate or coordinate with social security and other Federal and State retirement benefits.

The current integration rules were issued over a decade ago by the Internal Revenue Service. The rules are complex and out of date and were originally developed using an esoteric formulation related to the cost of social security benefits.

The omnibus bill introduces a conceptual framework intended to spur a discussion which will lead to the issuance of new integration regulations which are less complex and more relevant to present circumstances.

The concept of integration is fundamental to the continued growth of private pensions, and I am hopeful that as a result of the hearing process, the integration rules can be fine-tuned to the end that they will further the goals of the private pension system.

As I stated earlier, under the omnibus legislation, the policy of ERISA would be amended to include the encouragement of retirement savings. The bill includes IRA and Keogh provisions, which I am pleased to say were, for the most part, enacted into law as part of the President's tax bill.

Unfortunately, the new law does not include a provision making mandatory employee contributions deductible when made to a pension plan. I believe this provision should be vigorously pursued because it will encourage the establishment of new pension plans in cases where employers were previously reluctant or unable to fund for pensions at a meaningful benefit level.

In the legislation, we do not overlook those groups of employees who are not now covered under some type of retirement plan. Title V of the bill focuses on individual retirement incentives for employees who do not participate in employer-sponsored plans. In this case, employees would be allowed to participate in an IRA through a payroll withholding mechanism.

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I believe that many employers, instead of opting for IRA withholding, would be encouraged as a result of this provision to set up simplified pension or profit-sharing plans.

This brings me to the last title of the bill, title VI, which restructures the plan termination insurance program for single-employer pension plans. These changes are generally ones which the PBGC considers necessary in order to keep the title IV single-employer program solvent and free from abuse.

Basically, the self-financing nature of the program is now being threatened by employers having little or no net worth who have or are considering dumping their unfunded pension liabilities at the doorstep of the PBGC.

The bill changes the insurable event from plan termination to employer liquidation, and eliminates the current 30 percent of net worth cap on employer liability. The PBGC's claim is also reduced from that of a tax lien to general creditor status.

It is difficult for me to defend the title IV insurance program, much less these suggested changes, since I have opposed the concept of termination insurance since before ERISA was enacted. My general observation, after having worried about the consequences of termination insurance, is to recite what I refer to as "Erlenborn's rule No. 2." There is no No. 1, by the way; everybody asks. I just did not want anything to be preeminent. And Erlenborn's rule No. 2 is, "No experiment is ever a complete failure. It always can be used as a bad example."

It appears that termination insurance is here to stay, and given the jeopardy the program currently is in, it is best that we find a satisfactory solution to its problems. I believe that title VI contains an appropriate framework around which such a solution can be fashioned.

In summary, the omnibus ERISA provisions in S. 1541 and H.R. 4330 create a new retirement policy framework in which income security will be enhanced through increased retirement savings and pension plan formulation. By preserving our private pension system and strengthening it through tax incentives and other means, the bill sets the stage for expanded capital formation and increased productivity in the 1980s and beyond, which will lead to greater retirement income security for all of America's workers and their families.

Mr. Chairman, I compliment you for holding these hearings, and urge prompt consideration of this important legislation. Mr. Chairman, I have, in the interests of saving time, deleted portions of my statement and I would ask that the entire statement be incorporated in the record.

Senator **Nickles**. The entire statement will be incorporated in the record. Congressman, we appreciate very much your interest. I have a couple of questions.

In the first place, is there any movement on this bill in the House, or are you waiting for the Senate to move?

Mr. **Erlenborn**. Our chairman has not yet set hearing dates for this legislation, but has agreed to have general oversight hearings that will touch most all of the areas addressed in the bill. I cannot say that he ever will agree to take up the omnibus bill, but I think action here in the Senate and the knowledge of what we would have to go to conference with the Senate over, after the Senate has acted on this legislation, may lead to his determination in the future to set hearings on the omnibus bill.

Senator **Nickles**. I noticed that in discussing this with some of our colleagues, and also in speaking and visiting with various groups in the State of Oklahoma and elsewhere across the country, that there is widespread support from a variety of groups from all sides—business, labor and others—that are well aware of the fact that some changes need to be made.

Overall intent, I think, as you stated, was good, but there is the fact that some changes need to be made or the act itself could very much be a detriment to overall private pension plans.

Do you feel like that sentiment is shared in the House and in your district, and other places where you have been?

Mr. **Erlenborn**. No question about it. The tendency among the members of the House and the Senate, I think, is to blame the people in the bureaucracy for the troubles that ERISA is causing to the pension community. But the fact is, if we are honest about it, there are many things in the law itself that cause unnecessary paperwork.

The prohibited transaction section, for example, is one that has come in for wide condemnation in the pension community, and could be simplified. I think that Members of the House as well as Members of the Senate are quite aware of this and are looking forward to the opportunity to simplify ERISA and make it meet its original intention.

Across the country everywhere, those who are affected by ERISA, I think, are looking forward with great anticipation to the kinds of changes that are contained in the omnibus bill.

Senator **Nickles**. When did you first start becoming involved in the pension legislation? It was enacted in 1974, but given the amount of complicated legislation that was passed under ERISA, what was the amount of time and the steps that led to that passage?

Mr. **Erlenborn**. Well, I believe it was in the late sixties that the first serious consideration was given to such proposals. Congressman John Dent, who was Chairman of our then Subcommittee on General Labor which, at the time had jurisdiction in the House, began seriously holding hearings late in the sixties looking forward toward the enactment of such legislation.

It is interesting to note that the business community was then quite generally unsupportive of this effort. Over the course of the next several years, as more and more State legislatures began to take up similar legislation for State regulation of pension plans, the business community became aware that 50 different ERISA's in State legislatures would be very difficult to comply with if they had multistate operations or plans that covered employees in several different States.

That led, finally, in 1974, to an agreement—almost a demand by the business community that we move to enact this ERISA legislation and preempt State law. I got involved back there in the late sixties as the ranking minority member of the General Labor Subcommittee.

Senator NICKLES. You mentioned in your testimony that you had some reservations about title IV, or the termination insurance. The purpose of this hearing today is not on title IV, but I realize that you will not be coming back before our committee, and I do not really want to dwell on that.

What other serious reservations did you have about ERISA, as it is today, when it was being formulated?

Mr. ERLENBORN. Well, title IV certainly was my most serious reservation, and I moved in committee and on the floor to strike title IV, which I also did last year when we were considering the multiemployer insurance legislation.

My feeling was that by enacting vesting and funding rules, we were giving a greater measure of security to the employees who participated in pension plans and that the insurance program was unworkable and, in the multiemployer context, totally unfair and, I think, unconstitutional.

I also felt very strongly opposed to the ultimate inclusion in ERISA of the prohibited transactions provision. As I mentioned in my statement, this was not included in the House bill, and it was one of those areas where the Senate prevailed in the conference where I am very sorry that they did.

The prohibited transactions section has given more grief to more pension managers than any other part of ERISA, and I am sure these managers look forward with great anticipation to the opportunity to reverse the decision we made in 1974.

Senator NICKLES. To go a little further, the title IV, the prohibited transactions—and I am thinking here again, too, of comments that we have had from various individuals.

Our office was checking on the amount of paperwork that was required, and the act that we have and that you have been instrumental in, tries to simplify to a great degree the amount of reporting requirements.

As a businessman, I wrestled with the various reports and forms—the 5500's and the summary plan descriptions, and on and on and on. Do you feel like this is one of the things there is a lot of support for and that must be done if we are going to be able to regain some confidence in the private sector?

Mr. ERLENBORN. No question about it. On the House side, this is recognized by the chairman of our subcommittee, Congressman Phil Burton, by appointing myself and Congressman Peter Peyser of New York as a special task force on paperwork simplification.

The form 5500, as pointed out by the GAO in their recent report, includes too many questions, too many lines to be filled out. It is not utilized by the agencies who have demanded this information. The summary plan description, in some cases I think, has turned out to be much longer than the plan itself. Lawyers rightfully are fearful that, by putting the technical information that is in a plan into simple English, they may mislead employees and participants and create legal liabilities that the plan otherwise would not have.

ERISA itself required that the summary annual report be provided to every participant. This is a burdensome and costly requirement that is almost meaningless. The participants really do not want to know all the technical information that is in the summary annual report. What they want to know is what their rights are and how much they can expect, and the summary annual report does not even give them that information.

So, in the omnibus bill, we are providing that the requirement that that be furnished every participant be deleted and that it be available to anyone who asks for it, and therefore reduce an awful lot of cost and paperwork.

Senator NICKLES. I just happen to have a report by the Comptroller General on October 19, 1981 that shows all the various report forms, beginning with 5500 and the various 31 schedule A's, B's, C's, all the way to R; actuarial information, and then it goes over to EBS-1 and the annual premium filing form, et cetera.

That scares an employer with 15 employees who is working like the dickens to keep his head above water. Hopefully, we can have some positive things.

One other question; you spent quite a bit of time—and I have heard a lot of pluses and minuses, concerning the consolidation into the Employment Benefit Administration. Do you feel like that could be separated from the balance of the legislation, if there is not a consensus behind consolidation?

Mr. ERLENBORN. Well, I would hope that it would not be, Mr. Chairman, because I think it is key to the simplification to ERISA and absolutely essential if we are to have a consistent philosophy of enforcement.

I might say I was strongly opposed to the original concept of enacting, in effect, two pensions laws—one to be administered by the Labor Department and one to be administered by the Internal Revenue Service—two pension laws that were almost identical, but not quite.

That was a nonsettlement of an issue of jurisdiction. The managers of the bill in 1974 finally agreed that they never could compromise and settle that issue, so they just passed two separate laws.

We have two distinct philosophies of enforcement now being exercised by the IRS and the Labor Department. The Internal Revenue Service sees their role, and I think rightfully so, as maximizing the revenues for the U.S. Treasury. They could not care less about the protection of employees.

Their idea of a great way of enforcing ERISA is to disqualify a plan, causing its termination and denying to the participants the benefits that they have been relying on. Now, that, to the IRS, is, you know, a great way of enforcing ERISA, and it performs what they think their mission is, and that is maximizing the revenues to the Treasury.

On the other hand, the Labor Department does not like to impose penalties or see plans disqualified, and they see their role as protecting the rights of participants. Now, I just do not think we can go on with this kind of dual philosophy of enforcement of ERISA, and that is why I say the EBA is absolutely essential to having one, unified philosophy of enforcement.

It also will help reduce paperwork, which is another goal that is greatly to be desired. Mr. Chairman, a lot of people fear the EBA because they think that it will create another agency and more bureaucracy. The fact is that this is a deregulation move and will help to eliminate regulations now imposed on the pension community, and will reduce the number of people who are employed by the Government in the enforcement of ERISA.

It will actually reduce the cost of enforcement and reduce the paperwork. As I say, I think it is key, so I hope you will not think of that as something that can be separated out from the balance of the bill.

Senator **NICKLES**. I very much appreciate your comments, input and expertise in this field, and we look forward to working with you in the months to come on this piece of legislation.

Mr. **ERLENBORN**. Mr. Chairman, I would ask that a copy of a statement and a section-by-section analysis be incorporated in the hearing record.

Senator **NICKLES**. It will be incorporated.

Thank you very much, Congressman; we appreciate it.

[The prepared statement of Representative Erlenborn with attachments follows:]

STATEMENT BY
U.S. REP. JOHN N. ERLENBORN
OF ILLINOIS

BEFORE THE
SUBCOMMITTEE ON LABOR
OF THE
SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES

THE RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE
SIMPLIFICATION ACT

Wednesday, November 4, 1981

Mr. Chairman and Subcommittee members, our national pension system is at a crossroads. It is my belief that S. 1541, the Retirement Income Incentives and Administrative Simplification Act of 1981, sets forth the necessary blueprint for building on the strengths and correcting the weaknesses of our present system of providing retirement income.

Senator Nickles, you and the other sponsors of S. 1541, Senator Hatch and Senator Wallop, are to be congratulated for taking the lead role in the Senate in giving recognition to the need for the establishment of a rational retirement income policy. You can be assured of strong support and cooperation towards the early enactment of this legislation next year from myself and my colleagues in the House who have authored the identical measures, H.R. 4330 and H.R. 4334.

Various demographic and economic forces, and the stifling effects of the Employee Retirement Income Security Act (ERISA) itself, present a challenge to the means of providing retirement income in the 1980s and beyond.

The ERISA law is well-intentioned but flawed. Most recently ERISA's shortcomings were brought to the attention of Vice President Bush's Task Force on Regulatory Relief. ERISA was quickly placed on the list of regulations dubbed the "Terrible 20" -- the 20 having been determined to be the most burdensome and costly. For too long ERISA has been the subject of derision, inasmuch as the acronym has come to stand for "Every Ridiculous Idea Since Adam."

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Frankly, I believe it is time we give ERISA and the private pension system a boost, a new beginning. The need for a rational retirement income policy and a refocusing of ERISA has been well-documented in past congressional hearings and the reports issued by numerous commissions and study groups.

For example, the report issued earlier this year by the President's Commission on Pension Policy, which was established by President Carter in 1979, calls for "A long-term shifting of dependency on pay-as-you-go financed federal programs such as social security, welfare, and in-kind benefits programs to a balanced program of employee pensions, social security and individual effort." While I do not subscribe to all of the approaches recommended by the President's Commission, I believe their basic premise to be sound advice.

More recently, the Committee for Economic Development (CED), after a two-year study, released its comprehensive report advocating a three-tiered approach to retirement income policy based on:

> First, Social Security which should provide a basic floor of retirement income upon which an indivdual can build;
>
> Second, Employer provided pensions which can be improved and their coverage expanded through a number of tax and regulatory actions; and
>
> Third, personal savings which have been greatly neglected and which should be greatly expanded.

I agree with the conclusions in the CED report that a comprehensive, tripartite approach for strengthening the U.S. retirement system will produce additional savings that can finance increased investment in plant and equipment; and that, in this way, pension plans and personal savings will make an increased contribution to the economic growth that is essential to a sound retirement system in the future.

The CED report serves as a culmination of the fact-finding and groundwork which have been laid over the past few years as to the need for our country to address retirement issues in a comprehensive fashion.

The sentiment as expressed in the reports of the many retirement income study groups is that to expand participation, we need new pension plans and to enhance retirement income we need new retirement savings. This is the framework around which the omnibus ERISA legislative program embodied in S. 1541 and H.R. 4330 is structured.

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Up to this point, ERISA has not had as a purpose the expansion of the private pension system. In fact, ERISA, particularly in its early years, presented new obstacles to pension growth. The omnibus ERISA legislation would change that.

Under the Retirement Income Incentives Act, the declared policy of ERISA is, "to enhance employee retirement income security by establishing a rational policy -- (1) to encourage the establishment and growth of employee benefit plans, and (2) to encourage savings to meet the needs of employees and their families in the event of death, disability, or retirement."

The key to the successful implementation of a rational retirement income policy is the consolidation of Federal pension regulation under a single agency to be known as the Employee Benefit Administration (EBA). If the principal objective of ERISA, namely assuring that workers receive entitled benefits, is to be fully realized, a single agency must administer the law. Toward this end, the charter given the EBA is to "foster the orderly growth and maintenance of employee benefit plans."

The EBA would be headed by a full-time three-member Board of Directors consisting of a liaison officer from both the Labor and Treasury Departments and the Executive Director of the EBA, who would serve as Chairman. The PBGC would retain its present corporate character within the EBA with the membership of the EBA and the PBGC Board of Directors being identical (to prevent any future conflict in EBA and PBGC policies or operations).

By also serving as the Excutive Director, the EBA Chairman of the Board would be able to implement the policies set by the Board both efficiently and expeditiously.

The representation on the Board of the Department of Labor and the Department of the Treasury by their liaison officers provides assurance that pertinent labor law and tax law policies will be given due consideration.

The ERISA functions of the Secretaries of Labor and the Treasury would be transferred to the EBA, as would the functions of all other agencies and departments relating to employee benefit plans, subject to the discretion of the President. All regulations and rulings previously issued by the Treasury, IRS, Labor, and the PBGC would remain in effect. Any other Federal agency or Department issuing regulations affecting employee benefit plans would be required to consult with the EBA to avoid duplication and inconsistency.

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The functions and duties of the Secretary of the Treasury transferred are those under Titles I, II, and IV of ERISA, and those under other provisions of the Internal Revenue Code which relate to the formulaction of retirement income policy or to plan qualification and disqualification.

The enforcement functions under both Title I and Title II of ERISA would be transferred to the EBA. As a result, the enforcement remedies under Title II (for example, plan disqualification, excise taxes, and other penalties) would be exercised solely by the EBA in a coordinated fashion with other civil remedies under Title I of ERISA. The conflicting or duplicative enforcement activities under present law would be eliminated.

Importantly, any action by the EBA leading to the disqualification of a plan would be taken as a last resort only after all other remedies authorized under ERISA or the Internal Revenue Code have been exhausted. In other words, the protection of participant benefits would be given precedence over the heavy-handedness of plan disqualification.

The consolidation of ERISA administration under the EBA would simplify ERISA, end waste and duplication, and create a new, positive regulatory climate in which sponsors will be encouraged to establish new plans and expand existing ones.

The other titles of the ERISA simplification legislation build on this theme of expanding private pensions by instilling into the body of the law a new measure of certainty for plan sponsors. The litigious aspects of ERISA are reduced and the resulting savings in legal and other administrative costs can be translated into benefit improvements for participants.

For example, numerous suits have been brought challenging the pre-emption language under ERISA section 514. The legislation adds a new measure of certainty by reaffirming the broad federal pre-emption of State laws as was the original intent of ERISA.

First, the bill provides that a State insurance law which requires that a specific benefit be provided or made available by a contract or policy of insurance issued to an employee benefit plan is pre-empted and is not saved under the existing insurance exception. The proposal is intended to overrule the decision in Wadsworth against Whaland in which the first circuit held that ERISA did not pre-empt a State insurance statute requiring insurers to provide coverage in group health insurance policies for treatment of certain illnesses and disorders. If left uncorrected, Wadsworth would permit indirect State regulation of employee benefit plans and would encourage plans to avoid such regulation through self-insurance.

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In addition, the bill amends the pre-emption section to make it a matter of Federal law that benefits provided under an ERISA-covered pension plan may not be assigned or alienated. The purpose of the one exception to this rule is to reserve for the States their traditional control over marital and family matters and to aid plan administrators who are faced with the conflicting duties of obeying State court decrees to pay benefits to plan participants' former spouses and also of complying with the existing anti-alienation rule under penalty of plan disqualification.

The bill also clarifies the original intent of Congress in passing ERISA by restating in a positive fashion the areas of State and Federal securities laws which are inapplicable in connection with an employee's interest in an employee benefit plan. Firstly, a participant's interest in an employee benefit plan covered under ERISA is not to be considered a security or similar right for purposes of the Acts administered by the Securities and Exchange Commission. Secondly, ERISA pre-empts any provision of State law which defines or treats such a participant's interest in an employee benefit plan as a security or similar right.

A more certain regulatory atmosphere is also created by codifying the elapsed time rule and by clarifying that ERISA's ban on exculpatory provisions is not intended to prevent idemnification of fiduciaries by parties related to a plan.

The fiduciary provisions of ERISA have come under the most intense criticism for having created excessive burdens and uncertainty. To correct this situation, the bill seeks to simplify and clarify some of the concepts relating to the assignment and allocation of fiduciary duties. The bill modifies as well the provisions dealing with the general subject of co-fiduciary liability in an attempt to perfect the language consistent with the policy of ERISA.

Also, the bill replaces the draconian prohibited transaction standards under section 406(a) with the more workable standards originally adopted by the House of Representatives when the House considered the ERISA legislation in 1974. In addition to the general prudence and exclusive benefit requirements under 404, the 406(a) standards require plan transactions with parties-in-interest to meet tests involving adequate consideration, adequate security, and reasonable rates of interest which are not inconsistent with the fiduciary requirements under Section 404.

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Cases involving the more egregious and pervasive violation of ERISA's fiduciary standards transcend mere 406(a) violations, and the bill will provide a more effective enforcement mechanism for dealing with such cases by consolidating all enforcement remedies under ERISA and the Internal Revenue Code within the Employee Benefit Administration.

Until all enforcement responsibilities can be consolidated under the Employee Benefit Administration, the bill allocates the prohibited transaction enforcement responsibilities relating to pension benefit plans to the Department of Labor which has already been allocated most of the authority to issue exemptions pursuant to the President's Reorganization Plan No. 4.

The current 5 per cent and 100 per cent excise tax penalties under the Internal Revenue Code are replaced by discretionary 5 per cent and 100 per cent civil penalties under section 502(d) of ERISA.

Turning to another area of current concern to many plan sponsors, the bill contains a provision to clarify Congressional intent in connection with the nondiscrimination rules under IRC section 411(d)(1). The substance of the provision is also contained in H.R. 2775, a bill I co-sponsored with Congressmen Frenzel, Holland, Perkins, and Ashbrook. The bill codifies as "safe harbors" the "present value" and "cross-section" tests contained in the June 12, 1980 revision to the proposed Treasury regulations under section 411(d). The bill also codifies the result intended by the ERISA conferees that "4/40" vesting be a "safe harbor" except in the event there is found to be a "pattern of abuse" under a plan.

The omnibus bill contains many other provisions in the participation, vesting, funding, and fiduciary areas designed to eliminate specific burdens which have hindered plan development. For example, the bill clarifies and improves the provisions relating to joint and survivor annuities.

Most defined contribution plans have eliminated all optional annuity forms from their plans in order to avoid the current joint and survivor annuity requirements. The bill removes the disincentive for such plans to offer annuity options to their participants by exempting them from the J. & S. requirements (so long as the plan provides for 100 per cent vesting upon death).

The bill also directly addresses those paperwork requirements under ERISA which have been found to be costly and unnecesary to the protection of plan participants. To illustrate, the bill eliminates the near meaningless summary annual report (SAR) for all welfare benefit plans and requires posting, rather than individual distribution, of the SAR for pension plans.

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By preserving our private pension system and strengthening it through tax incentives and other means, the bill sets the stage for expanded capital formation and increased productivity in the 1980s and beyond which will lead to greater retirement income security for all of America's workers and their families.

I compliment you for holding these hearings and urge prompt consideration of this important legislation.

CONGRESSMAN JOHN N. ERLENBORN
Fourteenth District, Illinois

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FOR RELEASE: Thursday, Oct. 22, 1981

HOUSE TASK FORCE ON PENSIONS UNVEILS GAO REPORT CALLING FOR ACTION TO IMPROVE ERISA ADMINISTRATION

Congressmen John N. Erlenborn (R-IL) and Peter A. Peyser (D-NY), serving in their capacity as a task force on pensions under the House Subcommittee on Labor-Management Relations, today released a major General Accounting Office (GAO) study finding that "Better Management of Private Pension Plan Data Can Reduce Costs and Improve ERISA Administration."

Erlenborn stated that the GAO study is the latest in a series of Congressional oversight activities demonstrating the shortcomings of the Employee Retirement Income Security Act of 1974 (ERISA) and the need for early Congressional action.

Regarding the administration of ERISA's reporting requirements, the GAO study finds:

--because of IRS and Department of Labor mismanagement of the Form 5500 annual reports, the agencies have failed to obtain an accurate census of the plans under their jurisdiction and, as a result, have been unable to adequately enforce the filing requirements (In attempting to correct this situation, about 175,000 plans were unnecessarily harassed);

--IRS' failure to obtain missing annual report information covering more than 22% of all reports raises a question of whether all the data is needed and whether the plan sponsors are being overburdened;

--the Pension Benefit Guaranty Corporation (PBGC) lacks adequate data controls to insure premiums are collected and may have lost as much as $3.7 million in premium income in 1977 alone;

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--the need for filing summary plan descriptions with DOL is questionable, since DOL cannot readily locate 54% of the summaries and must again request summaries from plans for 21% of the 950 requests made each year by the public for such information.

Erlenborn stated that "the GAO study underscores the inefficiency, waste, and duplication that continues to plague ERISA as a result of the Act's multi-agency administration."

This past July 30 Erlenborn introduced ERISA omnibus legislation (H.R. 4330 and H.R. 4334) which addresses many of the issues raised in the GAO report. At that time, he stressed that "after nearly 7 years of ERISA oversight experience, it is quite clear that this administrative design has not worked. ERISA has been repeatedly included in a list of Government programs known for excessive bureaucracy. It has earned this reputation through well-documented examples of duplication and waste, confusion and delay, complexity and lack of inter- and intra-agency coordination. Each of ERISA's three administrative agencies has pursued its own individual and distinct policy leaving ERISA without a consistent policy of its own. H.R. 4330 would correct these shortcomings by consolidating all of ERISA's functions under the Employee Benefit Administration whose charter would be 'to foster the orderly growth and maintenance of employee benefit plans.'"

Erlenborn concluded that "the GAO findings are significant and their recommendations praiseworthy. I call upon my colleagues in the Congress and President Reagan to follow-up on the GAO study and support the early consideration of H.R. 4330 as a vehicle to implement the GAO recommendations."

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THE RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE SIMPLIFICATION ACT OF 1981 (H.R. 4330)

(Mr. ERLENBORN asked and was given permission to extend his remarks at this point in the Record and to include extraneous matter.)

Mr. ERLENBORN. Mr. Speaker, the bill I am introducing today with my colleagues, Messrs. Ashbrook, and Frenzel provides for the consolidation and simplification of the laws and administration relating to employee benefit plans, and also provides new incentives to increase retirement savings and to renew the growth and expansion of benefits and coverage under private pension plans. This bill, the Retirement Income Incentives and Administrative Simplification Act of 1981, sets a new course whereby private pension and other employee benefit plans may grow to meet the retirement income challenges of this Nation in the 1980's and beyond. An identical measure is being submitted today in the other body by Senators Nickles and Wallop.

Our national pension system is at a crossroads. The present means of delivering retirement income will be faced with far greater demands in the future. Barring significant changes in our national pension policy, each of the three major components in the delivery or retirement income—employer-sponsored pension plans, social security, and individual savings and investment—will be hard pressed to meet the retirement income needs of our Nation's working men and women.

The expansion of private pension coverage and benefit levels has been stayed for the moment, due to uncontrolled inflation, slower economic growth, and to a lesser extent, the effects of ERISA, the Employee Retirement Income Security Act of 1974.

The demographics of the future cast doubt on health of the social security system. It is difficult to foresee how current levels of support can be maintained, yet far too many workers already depend on social security benefits as their sole source of retirement earnings.

On the other hand, individual incentives for personal retirement savings and investment are not emphasized enough. New inducements will be necessary to encourage individual retirement intiatives, particularly during this era of shrinking disposable income, when this aspect of retirement planning is the first to be dismissed.

The Retirement Income Incentives and Adminstrative Simplification Act of 1981 sets forth the necessary blueprint for building on the strengths and correcting the weaknesses of our present system of providing retirement income. By preserving our private pension system and strengthening it through tax incentives and other means, the bill sets the stage for expanded capital formation and increased productivity in the 1980's and beyond which will lead to greater retirement income security for all of America's workers and their families.

Title I of the bill establishes the Employee Benefit Adminstration (EBA), a single independent agency to consolidate Federal regulation with respect to employee pension and welfare benefit plans. The EBA is charged to carry out a newly stated national policy under ERISA to: First, encourage the establishment and growth of employee benefit plans; and second, encourage savings to meet the needs of employees and their families in the event of death, disability, or retirement.

Title II permits Federal income tax deductions for employees who supplement their employer-sponsored pension with individual contributions to their plan or an individual retirement account (IRA). Experience in Canada under a similar provision suggests that nearly one-third of individuals earning $15,000 or more will expand their retirement savings when this provision of the bill is fully effective.

Title III clarifies, corrects, and simplifies current ERISA provisions in order to eliminate unnecessary plan expense and paperwork and to remove existing obstacles to orderly growth and plan formation.

Title IV amends the Internal Revenue Code to conform it with title III and to solve problems certain employees and plans have experienced with respect to lump-sum distributions, rollovers, and tax qualification. The contribution limits to H.R. 10 self-employed plans are doubled. The policy to allow plans to coordinate benefits with social security is updated and simplified.

Title V provides for voluntary IRA payroll withholding arrangements for employees who are not covered by employer-sponsored pension plans.

Title VI restructures the ERISA title IV single-employer plan termination insurance provisions to end abuses which threaten the continued viability and solvency of the program. While at this time it is not considered necessary for the Congress to statutorily alter accounting standards applicable to pension plans, the provisions under title VI changing the insurable event from plan termination to employer liquidation should render moot the current discussion in pension accounting circles as to any need for pension fund liabilities to appear as an item on the balance sheet of sponsoring employers.

In summary, our bill creates a new retirement policy framework in which income security will be enhanced through increased retirement savings and pension plan formation. We appeal to our colleagues in the Congress, and President Reagan as well, to set a new course responsive to the retirement needs of our Nation's workers and their families by quickly enacting the Retirement Income Incentives and Administrative Simplification Act of 1981.

A detailed summary of the bill's provisions follows:

SUMMARY OF H.R. 4330

TITLE I—EMPLOYEE BENEFIT ADMINISTRATION

The key to the successful implementation of a rational retirement income policy is the consolidation of Federal pension regulation under a single agency to be known as the Employee Benefit Administration (EBA). If the principal objective of ERISA, namely assuring that workers receive entitled benefits, is to be fully realized, a single agency must administer the law. Evidence shows that the unnecessary expense, confusion, and delay under ERISA's multiple administration have in the past caused an alarming number of employers to terminate existing employee benefit plans or refrain from establishing new ones. In this respect, multiple administration has thwarted the principal intent of ERISA.

During the development of ERISA, four legislative committees agreed, after considerable effort, to a complex arrangement by which agencies and departments would administer various parts of the law. Regulatory responsibilities in the areas of reporting, disclosure, vesting, funding, and plan termination insurance were divided among the Department of Labor, the Internal Revenue Service, including the Treasury Department, and the Pension Benefit Guaranty Corporation. Although a good faith effort was made to set forth the exact boundaries of each agency's responsibilities, many of us who were most closely involved in ERISA's development expected problems to arise.

After nearly 7 years of ERISA oversight experience, it is quite clear that this administrative design has not worked. ERISA has been repeatedly included in a list of Government programs known for excessive bureaucracy. It earned this reputation through well-documented examples of duplication and waste, confusion and delay, complexity and lack of inter- and intra-agency coordination. Each of ERISA's three administrative agencies has pursued its own individual and distinct policy, leaving ERISA without a consistent policy of its own.

The bill would correct these shortcomings by consolidating all of ERISA's functions under the Employee Benefit Administration whose charter would be "to foster the orderly growth and maintenance of employee benefit plans."

The EBA would be headed by a full-time three-member Board of Directors consisting of a liaison officer from both the Labor and Treasury Departments and the Executive Director of the EBA who would serve as Chairman. The PBGC would retain its present corporate character within the EBA with the membership of the EBA and the PBGC Board of Directors being identical—to prevent any future conflict in EBA and PBGC policies or operations.

By also serving as the Executive Director, the EBA Chairman of the Board would be able to implement the policies set by the Board both efficiently and expeditiously.

The representation on the Board of the Department of Labor and of the Treasury by their liaison officers provides assurance that pertinent labor law and tax law policies will be given due consideration.

The ERISA functions of the Secretaries of Labor and the Treasury would be transferred to the EBA, as would the functions of all other agencies and departments relating to employee benefit plans, subject to the discretion of the President. All regulations and rulings previously issued by the Treasury, IRS, DOL, and the PBGC would remain in effect. Any other federal agency or department issuing regulations affecting employee benefit plans would be required to consult with the EBA to avoid duplication and inconsistency.

The functions and duties of the Secretary of the Treasury transferred are those under titles I, II, and IV of ERISA; and those under Internal Revenue Code sections 401, 406 (a) and (b), 407 (a) and (b), 410, 411, 412, 413, 414, 415, 418, 418A, 418B, 418C, 418D, 418E, 4971, 4975, 6057, 6058, 6059, 6690, 6692, and 7476; and those under other provisions of the Internal Revenue Code—for example sections 219, 220, 404, et cetera—which relate to the formulation of retirement income policy or to plan qualification and disqualification.

The enforcement functions under both title I and title II of ERISA would be transferred to the EBA. As a result, the enforcement remedies under title II—for example, plan disqualification, excise taxes and other penalties—would be exercised solely by the EBA in a coordinated fashion with the other civil remedies under title I of ERISA. The conflicting or duplicative enforcement activities under present law would be eliminated. Importantly, in order to better protect participants, any action by the EBA leading to the disqualification of a plan would be taken as a last resort only after all other remedies authorized under ERISA or the Internal Revenue Code have been exhausted.

Such officers and employees would be transferred to the EBA as may be necessary to maintain and improve administration of the functions transferred and to assure a competent and qualified field force. In order that the present level of effort and expertise not be diminished, the President is directed to transfer officers and employees in the national and field offices of the Department of Labor and the Department of the Treasury—including the Internal Revenue Service—as may be necessary to accomplish this purpose. The President and the Board are granted the authority needed to accomplish the reorganization without causing disruption to the present level of effort or to employee's careers.

The existing Advisory Council on Employee Welfare and Benefit Plans would be transferred to advise the administration. As the terms of existing members expire, the President would appoint new members to the Council.

The Joint Board for the Enrollment of Actuaries would become the Actuary Enrollment Board, an entity under the jurisdiction of the EBA.

The EBA would be established not later than 2 years after the date of enactment, although the President could delay the transfer of any function which may be necessary to provide for a smooth transition.

The EBA will provide the necessary framework to deal, in a timely fashion, with emerging pension issues.

The creation of the EBA will finally give proper recognition to the vast significance of this Nation's 1.8 million private pension and welfare plans and their 75 million-plus participants.

TITLE II—DEDUCTIONS FOR RETIREMENT SAVINGS

Currently, individuals who are active participants in a retirement plan cannot establish an individual retirement account and cannot receive a tax deduction for their own plan contributions whether such contributions are voluntary or mandatory.

By providing tax deductions to plan participants for their own contributions, the bill will solve several problems which have manifested themselves under the current law. When an employee already participating in a plan desires to establish an IRA but is precluded from doing so, pressure is created for the employee to withdraw from the plan. On a collective scale, this pressure could jeopardize the plan's qualified tax status. The bill will eliminate the current pressure for employees to withdraw from plans.

The current law prohibiting participants from setting up an IRA works as a particular hardship on mobile employees such as engineers. Under the bill, employees who participate in the plan but terminate before they are vested would not receive any plan benefits, but they would at least have their IRA to fall back on.

Finally, under the bill, those who participate in inadequate plans—for example, profit-sharing arrangements when there is minimal profit—will have the freedom to set up their own IRA's or contribute to their own plans, if permitted, and receive a tax deduction.

The bill will also encourage the establishment of new pension plans in cases where employers were previously reluctant or unable to fund for pensions at a meaningful benefit level.

Both titles II and V of the bill provide new inducements for retirement savings among employee groups currently not covered by any pension plan.

The bill provides these necessary inducements: First, by increasing the deductible limit on contribution to individual retirement accounts—IRA's—from $1,500 to $2,000; second, by removing the present 15 percent of earned income limit on IRA's in order to simplify IRA administration and to induce low wage earners to save more; third, by permitting a deduction within the $2,000 limit for voluntary or mandatory contributions to employer-sponsored pension and savings plans; fourth, by permitting all employees to split their contributions in order to pay up to $1,000 into an IRA for their spouse, regardless of spousal earnings; and fifth, by removing the age 70½ restriction on contributions to IRA's and raising from 70½ to 75 the age at which distributions must commence.

The bill also equalizes the tax treatment of retirement contributions for private and public employees. Public employees covered under social security and paying the FICA tax could deduct up to $2,000 in contributions to their pension plan or IRA. Public employees not covered under social security would have the $2,000 deductible limit reduced by the amount of the FICA tax they would have had to pay if they had been covered under social security. Besides creating tax equity, a side benefit of this provision will accrue to the ailing social security trust funds. Groups of public employees in plans already covered under social security will in the future be less likely to pull out from under social security, since it would mean the loss of significant tax benefits to individual participants. This would halt the recent hemorrhaging of social security revenues due to the loss of taxes from public employee groups who have voluntarily withdrawn from the system.

The bill gives the Secretary of the Treasury authority to issue regulations concerning the filing of simplified reports in connection with this new deduction.

Conforming estate and gift tax amendments are also made by the bill.

TITLE III—ERISA CORRECTIONS, CLARIFICATION, AND SIMPLIFICATION

After nearly 7 years of congressional oversight of the Employee Retirement Income Security Act of 1974, it is high time for the Congress to make the necessary corrections to the law where shortcomings persist despite the best efforts of the agencies to make such corrections administratively. The establishment of the employee benefit administration under title I of the bill will automatically correct many of the severe and more vexing problems related to multiple agency administration.

ERISA's burdensome reporting requirements and bureaucratic redtape have frustrated the operations of existing plans and discouraged the establishment of new ones. A number of revisions can be made without adversely affecting participant protections, but which will make ERISA a more reasonable law and one that strengthens the private pension system.

Subtitle A—Amendments to definitions

The bill exempts certain severance pay and supplemental retirement income arrangements from the provisions of ERISA relating to pension plans. In many cases, employers have ceased their pre-ERISA practices of supplementing retiree pensions through ad hoc payments made only from the employer's general assets. The bill removes disincentives for employers to make such payments by exempting such practices from ERISA's pension plan requirements. The exemption contains a safe harbor rule for certain arrangements where the supplementary payments are limited to no more than the increase in the Consumer Price Index. The Secretary of Labor may define the parameters of other arrangements to be exempted. This provision modifies a similar provision in existing law which up to this point has been interpreted in an unnecessarily restrictive manner.

The definition of normal retirement age is clarified to permit benefit payments to commence at the beginning of calendar months.

The ERISA title I definitions of "governmental plan" and "party in interest" are amended to conform with such definitions under the Internal Revenue Code. A technical omission in the definition of "relative" is corrected.

Subtitle B—Reporting and disclosure

The bill eliminates the EBS-1 plan description requirement, since the Employee Benefit Administration will have available all necessary plan information through the filing of the plan qualification documents, the annual report form, and the summary plan description.

The bill eliminates unnecessary plan costs related to duplicative work in which accountants and actuaries may now be engaged with respect to plan reporting. The definition concerning the opinions of actuaries and accountants is changed so that the language reads that they "shall" rely on one another's opinions instead of that they "may."

The bill cuts down on unnecessary auditing of the assets and liabilities of common or collective trusts, separate accounts or separate trusts of financial institutions such as banks or insurance companies which are regulated and subject to periodic examinations by State or Federal agencies. Participants, of course, receive greater protection from a full audit which covers assets in such pooled trusts or accounts, but the cost of doing such an audit cannot be justified where the institution is already subject to periodic examination by a governmental agency.

The bill eliminates unnecessary costs connected with the annual reporting regulations for plans having "master trusts." The amendment provides for adequate reporting of plan financial information, but more appropriately with respect to all assets of the master trust.

The bill recognizes the action taken by the Department of Labor to revise schedule B of the annual report and, thus, eliminates section 103(d)(6) from the law—the requirements of which have been permanently waived by the Department.

The bill provides that simplified annual reporting apply to plans covering less than 100 active participants—that is employees. This modifies the current 100 "participant" rule whereby small plans can become subject to large plan reporting requirements merely through their continued operation over time.

A recent GAO study questions the cost-effectiveness of the requirement that the summary plan description be filed with the Department of Labor. The bill provides that an updated SPD be filed and furnished every 10 years rather than every 5 years as presently required. The lengthening of the filing period will enable the Employee Benefit Administration to determine whether the limited use justifies the costs of filing incurred by both plans and the Government.

The bill modifies the following requirement which has been determined not to be cost-justified. The summary annual report, which must be distributed to pension plan participants each year and which must disclose, among other things, the plan's assets and liabilities as well as its annual receipts and disbursements, is no longer required to be furnished individually. However, a summary annual report containing more meaningful information would have to be posted at employee worksites or published in company or union newsletters. Participants who are interested in the fiscal condition of their plans can request a copy of the full annual report which must be provided by the administrator. To assure that this report is practically available, the bill provides that an administrator can charge no more than $10 for a copy of the full annual report. The bill also makes the revised provision inapplicable to welfare plans.

The notice to interested parties currently required under ERISA section 3001 and section 7476 of the Internal Revenue Code is simplified to require posting (or alternative means of publication under regulation) and notification of collective bargaining agents within 60 days before and 15 days after the request for a determination is filed.

Under the bill, if an employee is interested in the amount of his own accrued benefit or account balance, he can request such information from the administrator who, under newly combined ERISA sections 105 and 209, must provide such information. Upon the separation from service and incurrence of a 1-year break in service by an employee, a plan administrator will be required to automatically disclose to the former participant his accrued benefit only if the benefit is vested. There is little point in requiring an administrator to bear the cost of notifying a former employee that he has no vested benefit. It is intended, however, that such an employee will have the right to request information on his accrued benefit, whether vested or not, before the occurrence of a 1-year break in service.

The bill seeks to preserve individual privacy and eliminate the harassment of employers and others connected with plans by requiring that any information provided individuals by the Department of Labor in computer-compatible form (such as tapes) not be utilized for the mass mailing of solicitations for any commercial purpose.

The bill amends section 110 of ERISA to clarify that alternative methods of compliance with the act's reporting requirements may be extended to welfare plans as well as pension plans. Subject to certain safeguards, the reporting of 3 per cent transactions is curtailed, as well as the filing of certain information relating to insured welfare and pension plans which is already filed with other regulatory bodies or available from other sources.

The bill also provides for alternative methods for distributing information to participants in multiemployer plans subject to certain safeguards and regulations.

Subtitle C—Participation and vesting

The bill permits the determination of pension plan eligibility on a plan-year basis, thus reducing plan administrative costs by allowing a single entry date each year to be used for such purposes.

The bill amends the multiemployer suspension of benefit upon reemployment rules. It clarifies that the term "employed" includes self-employment. It also permits the suspension of benefits for persons who have not retired but continue to work on an irregular basis. Finally, it permits the imposition of financial penalties for failure to notify the plan of re-employment.

The bill eliminates unnecessary confusion and administrative expense by clarifying that the employee notification and election requirement (section 203(c)(1)(13)), triggered when vesting schedules are changed, is only applicable to employees who might be adversely affected by the change.

The bill clarified that 125 days of service in any maritime industry shall be equivalent to 1,000 hours of service.

Under the bill, a multiemployer plan will be able to provide that a participant's accrued benefit upon his separation from the service is the sum of different rates of benefit accrual for different periods of participation as defined by one or more fixed calendar dates or by employment in different bargaining units. For purposes of the 3 percent accural method or the fractional method, the accrued benefit may be determined by projecting the normal retirement benefit to which a participant would be entitled if he continued to accrue benefits at the average of the rates applicable to this period of actual participation.

The bill makes several changes with respect to the calculation of optional forms of benefits which will reduce plan legal and other administrative costs. A new paragraph (24) is added to section 401(a) of the Internal Revenue Code to exempt a plan from a current IRS requirement that a plan be amended each time a change is made in the actuarial assumptions used to compute the actuarial equivalence of optional benefit forms (but only if the plan provides that the actuarial assumptions are set forth in a separate document which is made available to plan participants). Also, a plan offering optional benefit forms would not be treated as altering a participant's accrued benefits by reason of a change in the actuarial assumptions used to compute such benefits as long as the plan makes provision for disclosure as described above.

The current ERISA year of service, year of participation, and break-in-service rules relating to seasonal industries have proven to be inexplicable. Neither the Department of Labor nor the Department of the Treasury (which has assumed juriadiction over such rules under Reorganization Plan No. 4) has been able to make any headway in developing regulations with respect to these provisions. Neither should they attempt to do so given the present unworkability of such provisions. The bill includes the following new definitions with the intent being only to elicit comments as to their workability and not necessarily to suggest they offer a final solution to the problem. The concepts of "seasonal employee" (one who works less than 1,000 hours in a year) and "seasonal establishment" (one at which employment is limited by regular and recurring climatic conditions directly affecting the ability of the establishment to engage in its normal functions) are introduced, and plans in which a majority of the employees are seasonal employees would be required to use 500 hours, rather than 1,000 hours, for purposes of defining a year of service.

The bill contains several provisions necessary to correct the serious problem of delinquent employer contributions which threatens to undermine the equity and funding of multiemployer plans. Currently such plans are faced with the choice of either "kicking out" long-delinquent employers or curtailing the benefits of employees of delinquent employers. Removal by a plan of a delinquent employer is an unsatisfactory solution since it involves lengthy renegotiations, inordinate subsidies and expenses, and harsh treatment of employees who incur service breaks for purposes of both vesting and benefit accrual. The bill clarifies the circumstances under which a plan may reduce employee benefit accruals (but not service for vesting purposes) proportionate to employer contribution delinquencies, thereby providing plans with an equitable yet effective means of deterring contribution delinquencies. Safeguards require a plan to make diligent efforts to collect delinquent contributions after notice to the employer and employer representatives and to restore employee benefit accruals when such efforts are successful.

The bill clarifies and improves the provisions relating to joint and survivor annuities. Most defined contribution plans have eliminated all optional annuity forms from their plans in order to avoid the current joint and survivor annuity requirements. The bill removes the disincentive for such plans to offer annuity options to their participants by exempting them from the J. & S. requirements (so long as the plan provides for 100 per cent vesting upon death). This provision is in concert with the recent Tax Court holding in *BBS Associates, Inc.* v. *Commissioner* which we endorse. In addition, the bill clarifies that a J. & S. option must be provided to a disability retiree only when the disability begins after the qualified early retirement age. Also, the bill clarifies that a plan need not offer a preretirement survivor annuity option if the preretirement death benefit is automatic and is at least the actuarial equivalent of the survivor annuity, and the plan allows the participant to elect to have the death benefit paid in the form of a survivor annuity. Also the bill clarifies that the right of a participant to revoke an election of an annuity option is not to extend beyond the later of the participant's annuity starting date, or the date on which the participant first applies for benefits. Finally, the bill clarifies that a person other than the spouse may be designated as beneficiary under a qualified joint and survivor annuity, provided the spouse gives written consent (this provision does not require such written consent for other optional annuity forms which a plan may provide).

Currently, courts are ignoring ERISA's preemption of State law with respect to community property laws and alimony and support decrees. Plans which obey court orders to pay benefits in violation of ERISA's prohibitions against assignment and alienation may be placed in tax jeopardy or found to be in violation of plan provisions. The bill ends this confusion by making the prohibition of benefit assignment and alienation specific in Federal law, with an exemption allowing plans to pay certain benefits pursuant to state court decrees of divorce, annulment, legal separation, or family support. The applicable decree must provide that the payment is required and specify the amount, and that the obligation is the participant's. In addition, the decree could not require a plan to alter its terms of payment. A plan would have to be notified of the court decree to be obligated for future payments. Both the plan and the other party would be required to give certain notification to each other before payments could be made.

The bill would clarify Congressional intent by codifying the existing regulations pertaining to the elapsed time method of determining length of service.

Subtitle D—Funding provisions

The bill clarifies that the amortization (funding) period connected with changes in actuarial methods is the same as the period connected with changes in actuarial assumption.

The alternative funding method is made workable for the well-funded plans using this method by permitting such plans to amortize unfunded past service liabilities over 30 years when the plan switches back to entry-age-normal funding (which usually occurs at the time benefits are increased substantially).

The bill amends the law to require the approval of changes in funding method or plan year only when such changes are made more than once in a 3-year period. This provision eliminates delays and unnecessary plan and governmental costs.

The bill clarifies existing law by specifying that all plan provisions requiring future benefit adjustments must be taken into account for funding purposes (in particular, the actuarial assumptions used in projecting benefits subject to automatic cost-of-living increases would have to conform with the reasonableness and actuary's best estimate tests).

Elsewhere in the bill are additional changes to the funding provisions which will result in greater benefit security by increasing both the maximum contribution limit and the minimum funding standard for single employer plans.

Subtitle E—Fiduciary provisions

In order to make more types of insurance available to plans and to codify the agency's interpretation of ERISA regarding insurance company general accounts, the bill provides with respect to a plan which is funded by a contract, or policy of insurance, including, but not limited to guaranteed benefit policies, that such a plan's assets shall include such contracts or policies, but not the insurer's general account assets.

The bill seeks to simplify and clarify some of the concepts relating to the assignment and allocation of fiduciary duties. Under the bill "named fiduciaries" are to be designated in a plan instrument or pursuant to a procedure in a plan instrument. This will provide certainty as to which plan fiduciaries, jointly or severally, have authority to control and manage the operation and administration of the plan. The bill also makes clear that such named fiduciaries may allocate duties among themselves, may designate others as fiduciaries to carry out specific fiduciary activities, and may direct plan trustees. Plan trustees must be "named fiduciaries" or appointed by a "named fiduciary." Throughout Part 4 the concept of fiduciary "duty" replaces the somewhat cumbersome phrase "responsibility, obligation, or duty" and is intended to encompass the scope of the replaced language.

The bill makes a correction to the exceptions allowed under ERISA's nonreversion provision by clarifying that contributions made by an employer to a plan by a mistake of fact or law may be returned in the case of a collectively bargained plan to which more than one employer contributes (whether such a plan meets the definition of "multiemployer plan" or not). The period for the return of contributions or payments is made uniform under all such exceptions.

The bill modifies the provisions dealing with the general subject of co-fiduciary liability in an attempt to perfect the language consistent with the policy of the Act. Generally the policy of ERISA is to impose fiduciary responsibility for the activities of others in four circumstances:

(1) where the fiduciary is vested with some duty of supervision by the terms of the plan (e.g. section 405(c));

(2) where the fiduciary is a culpable participant in a breach (e.g. section 405(a)(1));

(3) where the fiduciary is guilty of a breach which gives rise to or occasions the breach of another (e.g. section 405(a)(2)); and

(4) where the fiduciary has knowledge of the guilt of another and fails to take action appropriate to the circumstances (e.g. section 405(a)(3)).

The first two circumstances are clearly subject to the sanctions under section 404, and in both cases liability would be imposed under section 409 by operation of section 404. It is intended under the bill that the identical requirements of section 404 carry out the policy as to these two situations. The third circumstance describes not a standard of conduct, but rather, articulates a measure of damages. Like the first two situations the language of ERISA section 405 creates the appearance of a redundancy, in this instance with section 409. The bill eliminates this apparent redundancy, and under section 409, as revised, it is clear that fiduciaries are liable for all losses resulting from their breach. This would be true for those losses they themselves directly occasion as well as those that are causally related to their action. The fourth circumstance is by far the most troublesome to deal with, and the language in section 405 of the ERISA appears not terribly well suited to the policy. The problem arises because the policy in ERISA generally seeks to insure that responsibilities under the Act be directly related to the assumption of duties, and the bill carefully adheres to that policy by requiring that certain persons (named fiduciaries and trustees) assume enumerated duties. These provisions insure that individuals will be responsible for all the activities undertaken by any plan. The dilemma is the extent to which knowledge alone should be relied on to impose responsibility on an individual fiduciary. As it now stands ERISA could be misread to give rise to such a responsibility where a fiduciary has bare knowledge of the acts or events comprising the breach of another. This interpretation is troublesome as it does violence to the principle that those on whom a responsibility is to be imposed need be given some prior notice of the dimensions and possible consequences of their obligation. Generally the bill satisfies the requirement of prior notice by associating the assumption of a duty with either a formal designation or the commission of some overt act. Reliance on knowledge alone would raise the very real possibility of a responsibility being imposed on totally unsuspecting individuals. Additionally, if bare knowledge is to be the "trigger," imposing, by itself, responsibility on a person, many have expressed concern that the net of potential liability will extend well beyond the group that any equitable policy would seek to hold accountable. Certainly, more than bare knowledge of events was intended to be a prerequisite to imposing responsibility under FRISA section 405. Most probably two additional elements were intended, knowledge that a breach has occurred and some incident of the existing fiduciary relationship which gives rise to a duty to act. Unfortunately the language of ERISA is at best uncertain on this point. It is our intention to explore this issue by means of the hearing process in order to reach a clear statutory statement of fiduciary responsibility in this circumstance.

From the time of ERISA's enactment the law has been characterized in numerous press accounts as being excessively burdensome. The oversight record shows that witnesses have directed their most critical comments to the prohibited transaction provision under section 406(a).

The point of their comments is that the scope of the 406(a) prohibitions, insofar as they affect the conduct of parties in interest who are not fiduciaries, is overly broad in relation to the Act's policy objectives. They have not suggested, nor would we consider, changes to the provisions to section 406(b) prohibiting fiduciary self-dealing and disloyalty or to the major fiduciary obligations arising under section 404. ERISA section 406(a) embodies a system of prior restraint directed at all dealings between a plan and any person who has a prior relationship with the plan. The theory on which it is based has, on occasion, been described as the prophylactic inter-position of the public interest in transactions which involve a high risk of abuse. Proponents argue that the probability that parties in interest will influence plan decisions to their own benefit compels the prohibition, subject to an exemption being granted under section 408. In their view any person with a prior relationship to the plan, is vested with the potential to exercise undue influence over their subsequent dealings with the plan. This viewpoint and the provisions of section 406 have some interesting parallels in the treatment of tax exempt foundations in the 1969 amendments to the Internal Revenue Code. In that situation dealings between a foundation and certain disqualified persons were prohibited. The thrust of those provisions was to prevent the use of tax exempt charitable funds to further the economic interests of donors, their families, or the managers of foundations. The purpose of that legislation was limited to establishing conditions for tax exemption and the main regulatory effort was left to state law. The use of prior restraint in the context of foundations, because of their few numbers and their non-commercial nature proved to be a relatively workable standard, for the limited purpose of tax qualification. Unfortunately, the parallel does not extend to the effect of section 406(a) on the day-to-day operations of an employee benefit plan. The ERISA hearing record is replete with examples of transactions involving non-fiduciary parties-in-interest being prohibited to no purpose. Based on these examples it is clear that in most employee benefit plans of any size even the most routine transaction can run afoul of section 406(a). Further the breadth of the prohibited group and the difficulty in identifying all parties-in-interest make it problematical whether any fiduciary in an employee benefit plan can really be certain he is not participating in a transaction violating section 406(a). There is a strong suspicion that the practical impediments to complying with the section and the absurdity its application in some cases, may have led many otherwise honest fiduciaries to consciously disregard its requirements. Much has been made of the exemption process and its availability to provide flexibility in the impact of the section. However, few if any past witnesses have expressed any degree of satisfaction in the practical effects of the exemption process. The process has proven to be slow, cumbersome and not surprisingly, bureaucratic. These broad prohibitions, when applied to the commercial transactions which are the lifeblood of any employee benefit plan, impose an enormous burden on these plans. That burden is not mitigated by the exemption process, nor is it offset by any benefit derived from avoiding transactions with non-fiduciary parties-in-interest. Therefore, the bill replaces the draconian standards under 406(a) with the more workable standards originally adopted by the House of Representatives when the House considered the ERISA legislation in 1974. In addition to the general prudence and exclusive benefit requirements under 404, the 406(a) standards require plan transactions with parties-in-interest to meet tests involving adequate consideration, adequate security, and reasonable rates of interest which are not inconsistent with the fiduciary requirements under section 404. Cases involving the more egregious and pervasive violation of ERISA's fiduciary standards transcend mere 406(a) violations, and the bill will provide a more effective enforcement mechanism for dealing with such cases by consolidating all enforcement remedies under ERISA and the Internal Revenue Code within the Employee Benefit Administration.

With respect to the definition of "qualifying employer real property," the bill clarifies that "a substantial number of the parcels must be dispersed geographically" only when three or more parcels are involved. This modifies the current interpretation placed on the definition of qualifying employer real property which has the irrational result that a single parcel of such property cannot qualify because it cannot be dispersed geographically.

Until all enforcement responsibilities can be consolidated under the Employee Benefit Administration, the bill allocates the prohibited transaction enforcement responsibilities relating to pension benefit plans to the Department of Labor which has already been allocated most of the authority to issue exemptions pursuant to the President's Reorganization Plan No. 4. The current 5% and 100% excise tax penalties under the Internal Revenue Code are replaced by discretionary 5% and 100% civil penalties under section 502(i) of ERISA.

As stated earlier, the prohibited transaction provisions under ERISA have been roundly criticized as being excessively burdensome. This has led to the perception that ERISA is an extremely oppressive law and one from which employers, who would otherwise set up a plan for their employees, should steer clear. The failure of the Department of Labor to provide class exemptions for transactions beneficial to plans and important to the expansion of plans, particularly in the small plan area, has greatly hampered the growth in coverage under private pension plans. In order to eliminate present barriers to plan expansion and to spur capital formation, the bill provides a statutory class exemption for loans and leases made by a defined contribution plan to the major employer establishing and maintaining the plan. In addition to the prudence, diversification, and other fiduciary requirements under section 404, such transactions would have to meet specified tests requiring adequate security, and adequate consideration and rates of interest not less than that which would be obtained in an arm's length transaction with an unrelated third party. Under the exemption, such transactions could not total more than 50% of plan assets. The provision is limited in order to target new plans which are principally defined contribution plans for small employers.

The bill clarifies that not only plan fiduciaries but also parties-in-interest may receive plan benefits they are due or reasonable compensation for services they may render to the plan. This provision eliminates any unintentional construction that plan participants, because they are included in the definition of party-in-interest, cannot be paid their benefits without causing the plan to violate the prohibited transaction rules under section 406.

The bill makes a correction to section 408(d) of ERISA which inadvertently makes the exemption procedure relating to prohibited transactions currently unavailable to persons who are "owner-employees."

The bill provides that, for purposes of sections 406 and 407, the assets of a plan shall not include assets in a pooled separate account of an insurer or assets in a collective investment fund of a bank or similar financial institution supervised by the United States or a State. This provision is directed at the unworkability of the prohibited transaction provisions as they relate to institutional investment managers and should lead to reduced employee benefit plan costs. The present statutory framework of prohibiting large blocks of transactions without qualification, including many that constitute long-standing normal business practices, and leaving exceptions to the time-consuming administrative exemption procedure, is an example of clear overregulation for institutional investment manages which are subject to strict regulation by State or Federal agencies.

In a related provision, the bill eases the policing of the 10% limitation under section 407(a) by allowing separate accounts on insurers and common or collective trusts to enter into written understandings with plans that the aggregate fair market value of employer securities and real property will not exceed 10% of the fair market value of the assets of the separate account or trust.

The bill provides clarification (consonant with currently applicable regulations) that ERISA's ban on plan exculpatory provisions is not intended to prevent indemnification of fiduciaries by parties related to the plan. The bill also makes it clear that among the various indemnification practices permitted under ERISA, a multiemployer plan may in certain situations pay the cost of defending plan trustees and may indemnify them subject to a determination that the trustees acted in good faith. The intent is to better enable plans to retain competent trustees by permitting honest fiduciaries to carry out their responsibilities without fear of personal liability for the large potential costs of defending challenges to plan decisions. The provision will also minimize the dependency of plans on costly insurance thus creating cost savings which will inure to the benefit of plan participants.

Subtitle F. Amendments to ERISA title I, part 5

The bill corrects an omission made under sections 515 and 502(g)(2) in connection with the collection of delinquent employer contributions under multiemployer pension plans. First, an express statute of limitations, consistent with the statute of limitations applicable to other provisions under ERISA, is made applicable to section 515. Also, the amendment makes clear that actions to collect delinquent contributions may be brought in state courts as well as Federal courts.

To improve administration, the bill provides that amounts collected by the Department of Labor from persons requesting information are to inure to the Department.

In order to assure small plan sponsors of an adequate voice on the Advisory Council on Employee Welfare and Pension Benefit Plans, the bill requires that at least one member of the Council shall be representative of employers maintaining small plans.

The Department of Labor and the Department of the Treasury have been totally unresponsive to repeated requests by the Congress for information currently reported by plans to the Departments. The bill requires the Secretary of Labor to publish a report at least annually showing the number of plans and plan participants, plan assets, and other plan information by type and size of plan. This report is to be prepared based on existing information already filed with the Departments and requires no additional reporting by plans.

Increasingly the courts are challenging the preemption language under ERISA section 514. The bill affirms the broad Federal preemption of State laws as was the original intent of ERISA. First, the bill provides that a State insurance law which requires that a specific benefit be provided or made available by a contract or policy of insurance issued to an employee benefit plan is preempted and is not saved under the existing insurance exception. The proposal is intended to overrule the decision in Wadsworth against Whaland in which the first circuit held that ERISA did not preempt a State insurance statute requiring insurers to provide coverage in group health insurance policies for treatment of certain illnesses and disorders. If left uncorrected, Wadsworth would permit indirect State regulation of employee benefit plans and would encourage plans to avoid such regulation through self-insurance. Two exceptions to this general rule are expressly permitted under the bill. The first allows States to require "conversion" features in contracts and policies of insurance, and the second allows the States to require so-called "freedom of choice" provisions in such contracts and policies.

In addition, the bill amends the preemption section to make it a matter of Federal law that benefits provided under an ERISA covered pension plan may not be assigned or alienated. The purpose of the one exception to this rule is to reserve for the states their traditional control over marital and family matters and to aid plan administrators who are faced with the conflicting duties of obeying State court decrees to pay benefits to plan participants' former spouses and also of complying with the existing antialienation rule under penalty of plan disqualification. The particulars of this exception are contained in the amendment to the antiassignment and alienation provision described earlier under subtitle C.

The bill also clarifies the original intent of Congress in passing ERISA by restating in a positive fashion the areas of State and Federal securities law which are inapplicable in connection with an employee's interest in an employer benefit plan. Firstly, a participant's interest in an employer benefit plan covered under ERISA is not to be considered a security or similar right, for purposes of the Acts administered by the Securities and Exchange Commission. Secondly, ERISA preempts any provision of State law which defines or treats such a participant's interest in an employer benefit plan as a security or similar right. These provisions underscore the understanding of the Congress at the time of ERISA's passage as to the applicability of the securities laws as stated as follows in the Interim Report of Activities of Private Welfare and Pension Plan Study (Senate Report No. 127 93d Congress, 1st Session (1973)):

"Pension and profit-sharing plans are exempt from coverage under the Securities Act of 1933 . . . unless the plan is a voluntary contributory pension plan and invests in the securities of the employer company an amount greater than that paid into the plan by the employer. A voluntary contributory plan is one to which both the employee and employer contribute and in which employees voluntarily participate. If the plan's investment in the employer's securities exceeds the employer's contribution, both the employer's securities and the interest in the plan must be registered under the Securities Act with the SEC."

In *International Brotherhood of Teamsters v. Daniel* the Supreme Court stated that the enactment of ERISA "undercuts all arguments for extending the Securities Act to non-contributory compulsory pension plans." In *Newkirk v. General Electric Company* the District Court for the Northern District of California stated that "the rationale behind the *Daniel* holding is applicable also to a contributory non-compulsory pension plan." In *Tannuzzo v. Grolier, Inc.* the District Court for the Southern District of New York found that even an employee's interest in a voluntary contributory pension plan could not be a security interest demanding and deserving protection under the 1933 and 1934 Securities Acts. We agree with the interpretation by the several courts with respect to the issues presented. The bill merely reemphasizes and clarifies these court decisions as a correct interpretation of Congressional intent.

Subtitle G—Miscellaneous

The bill makes numerous corrections of typographical, grammatical, and other technical errors in ERISA. The bill also provides for the consolidation of the PBGC 1 annual premium payment form with the 5500 annual report form.

Subtitle H—Recommendations by the agencies

Consonant with the policy of the bill to simplify ERISA and to reduce complexity and unnecessary paperwork, the Secretary of Labor and the Secretary of the Treasury are directed to make a joint recommendation as to how ERISA report requirements may be changed to take into account the different types and sizes of plans. For example, administrators of welfare plans should not have to struggle with the more complex instructions and requirements pertaining to pension plans. This provision of the bill also states that no regulation or form relating to cyclical reporting requirements for small plans shall become effective prior to the implementation of this section of the bill.

To encourage the growth of pension plan sponsorship, the bill makes provision for the eventual establishment of special master and prototype pension plans. Within one year after the date of enactment, the Secretary of Labor and the Secretary of the Treasury are to jointly recommend legislation to enable certain institutions, such as banks, savings, and loan associations, and insurance companies, to develop special master and prototype plans for adoption of employers. It is anticipated that many employers who would otherwise be reluctant to establish plans will do so when the sponsoring institution assumes the major administrative and fiduciary burdens under such special plans.

TITLE IV—INTERNAL REVENUE CODE AMENDMENTS

Subtitle A of title IV of the bill conforms the Internal Revenue Code of 1954 to the amendments made to ERISA under title III. Subtitle B contains the following substantive amendments.

Code section 402 is amended to clarify that employee participation in predecessor plans or other plans of related employers is to be counted toward the eligibility requirement for lump sum distribution treatment.

Under the Internal Revenue Code certain defined contribution plans and defined benefit plans of an employer are treated separately for purposes of determining whether an employee has received a "lump sum distribution." However, the code does not contain similar rules for multiemployer plans and plans established by tax-exempt organizations. The bill provides that in the case of multiemployer plans and plans maintained by organizations described in section 501(c)(3) (relating to charitable and educational organizations) or section 501(c)(5) (relating to labor, etc. organizations) separate treatment with respect to defined benefit and defined contribution plans will also apply. Thus, the bill makes clear that plans established by these organizations can be classified as defined benefit and defined contribution plans and that separate distribution from the plans can receive lump sum distribution treatment. With respect to all other employers, all defined benefit, all money purchase, all profit sharing, and all stock bonus plans are to be treated separately for purposes of the lump sum distribution rules.

Because multiemployer plans provide portability of pension credits among the various employers maintaining the plans, and because such plans exist in industries where changes of employment are frequent, difficulty has arisen in some cases in determining when a "separation from the service" occurs in the context of a multiemployer plan for purposes of determining qualification for favored tax treatment of certain lump sum distributions under section 402(e) of the Internal Revenue Code. In order to resolve this issue, the amendment to section 402(e)(4) made by the bill specifies that a separation from service shall be deemed to have occurred in the case of a multiemployer plan if any employee has not worked for a period of 6 consecutive months.

In order to make target benefit plans more attractive in terms of providing past service benefits for older workers, the bill requires new target benefit plans (and allows current plans to elect) to meet the defined benefit rather than the defined contribution limitations of Internal Revenue Code (IRC) section 415.

Currently employee contributions to a qualified private or public employer pension plan are not deductible and, therefore, upon withdrawal from a plan cannot be rolled over into an individual retirement account (IRA) to accumulate additional tax-deferred earnings. In order to enhance the portability of employee contributions, the bill allows lump sum employee contributions to be rolled over into an IRA and to be rolled over from an IRA back into a qualified pension plan.

Under section 514 of the Internal Revenue Code, the otherwise tax-free income of a tax-exempt organization, including a pension trust, may be subjected to income tax to the extent that it constitutes so-called "unrelated debt financed income." Thus, a pension trust which borrows against the security of its assets, including insurance policies, may find that a portion of the income which is generated for the sole purpose of providing retirement benefits is burdened with income taxes which reduce the amount of trust assets that are ultimately available for retirement benefits. Therefore, the bill amends the term "acquisition indebtedness" under IRC section 514 so as not to include indebtedness incurred by a qualified trust to an insurer to the extent the indebtedness is secured by a contract for life insurance with such insurer.

In order that employees working beyond normal retirement age not be unfairly penalized, the bill clarifies the application of the defined benefit plan limitations under IRC section 415(b)(1)(B) as an amount not less than the actuarial equivalent of the amount which would have been determined if the retirement income benefit had begun at normal retirement age.

Since the passage of ERISA, the minimum funding standards under the Act have in many instances proved inadequate to restrain unfunded liabilities from escalating to unsupportable levels. The legislation passed last year improved funding levels somewhat in connection with multiemployer pension plans. Under title IV of the bill, the funding requirements for single-employer plans are also strengthened to reduce the risk and exposure to the PBGC. In order to retain current levels of funding flexibility and to encourage faster funding, the bill amends IRC section 404 to allow past service liabilities to be amortized over 5 years (a reduction from the current 10 year limitation).

The current limitations on contributions to H.R. 10 plans has created a flood by self employed persons and partnerships to incorporate in order to be treated in a less disparate fashion in connection with such pension contributions. In order to eliminate some of the disparity in tax treatment, the bill increases from $7,500 to $15,000 the maximum contribution on the first $100,000 of income under H.R. 10 plans. The accruals under defined benefit plans for the self-employed are also increased proportionately.

The bill contains a provision to clarify Congressional intent in connection with the nondiscrimination rules under IRC section 411(d)(1). The substance of the provision is contained in H.R. 2775, a bill co-sponsored by Reps. Frenzel, Erlenborn, Holland, Perkins, and Ashbrook. The bill codifies as "safe harbors" the "present values" and "cross-section" tests contained in the June 12, 1980, revision to the proposed Treasury regulations under section 411(d). The bill also codifies the result intended by the ERISA conferees that "4/40" vesting be a "safe harbor" except in the event there is found to be a "pattern of abuse" under a plan.

A key element in the development of a rational retirement income policy is a degree to which qualified pension plans can "integrate" or coordinate pension benefits with Social Security and other Federal and State retirement benefits. The current integration rules spelled out in Rev. Rul. 71-446 were issued over a decade ago by the Internal Revenue Service. The rules are complex and out of date, and were originally developed using an esoteric formulation related to the "cost" of Social Security benefits. The bill introduces a conceptual framework intended to spur a discussion which will lead to the issuance of new intergration regulations which are less complex and more relevant to present circumstances. The basic tenets of the amendment to IRC section 401(a)(5) are as follows: (1) each benefit type under a plan (retirement, disability and survivor's) is tested separately to determine if it meets the integration rule; (2) a defined benefit offset plan is used to describe the basic integration rule while other plans with other forms of integration formulas must conform to similar principles; (3) the general rule states that a plan is not to be considered discriminatory if it meets the "minimum combined-benefit rule" and the "benefit-compensation ratio" for lower compensated participants is not less than the "benefit-compensation ratio" for higher-compensated participants; (4) the "benefit-compensation ratio" is defined as the ratio of (A) the sum of the participant's plan benefit and the applicable Federal and State benefits which are offset (e.g. Social Security) to (B) the participant's compensation; (5) the "minimum combined-benefit rule" requires that a properly integrated plan provide combined pension plan and Federal and State benefits equal to at least 50% of 5-year average compensation for each participant earning less than the average annual wage covered under Social Security (the 50% is adjusted for persons who are under age 65 with less than 40 years of service); (6) in addition or as an alternative, a plan may be integrated by "capping" pension benefits so that in combination with Social Security (or other applicable Federal and State benefits) the combined benefits are not less than 80% of the participant's average annual compensation. The concept of integration is fundamental to the continued growth of the private pension system. We are confident that the above principles can be fine-tuned to form the basis for a reasonable and responsive national pension policy.

TITLE V—INDIVIDUAL RETIREMENT PAYROLL DEDUCTION ARRANGEMENTS FOR EMPLOYEES NOT COVERED BY PENSION PLANS

This title of the bill focuses on individual retirement incentives for employees who do not participate in employer-sponsored plans. In this case, employees would be allowed to participate in an IRA through a payroll withholding mechanism.

All employees not currently or ultimately eligible to be covered under a pension plan would be eligible for IRA withholding. Employers would not have to withhold unless 10 percent or more of the employees sign up to payroll withholding. Once the withholding began, employers would be obligated to forward individual contributions to one or more IRA sponsoirs of the employer's choosing.

IRA withholding would not be required of all employers. Employers who have not been in business for 5 years and small employers (those having fewer than 20 employees) are encouraged but not required to withhold.

IRA withholding will provide a viable mechanism for individual retirement savings within the workplace to employees who currently lack such a device. Even though the same incentives are currently available under the conventional IRA, voluntary withholding will provide many employees with the discipline to save which they now lack on their own.

To assist employees, the amount withheld under an arrangement established pursuant to title V would be shown on the employee's W-2 wage form. The Employee Benefit Administration established under title I will administer the provisions of title V.

TITLE VI—SINGLE-EMPLOYER TERMINATION INSURANCE AMENDMENTS

In 1979 the Pension Benefit Guaranty Corporation (PBGC) reported to the Congress that the Contingent Employer Liability Insurance (CELI) program under ERISA section 4023 was unworkable, and as a result this provision was repealed by the Multiemployer Pension Plan Amendments Act of 1980. While recommending the repeal of CELI, the PBGC also reported on the weaknesses of the termination insurance program relating to single-employer plans and suggested several fundamental changes.

A principle recommended by the PBGC which was generally supported by an outside panel of experts would require employers to continue funding vested benefits after plan termination. A consensus was also reached that the insurable event under title IV should be changed from plan termination to the insolvency of the employer sponsoring the plan. Recent events have further demonstrated the need to restructure the single-employer termination insurance program along the lines of the PBGC recommendations; and title VI of the bill is intended to implement the suggested changes.

Swift enactment of the bill is imperative in order to protect the financial stability of the single-employer insurance program from potentially devastating losses which are actually encouraged under present law. Currently, employers, even those who continue in business and are not necessarily in any particular financial difficulty, can terminate their pension plans and limit their liability to 30 percent of their then current net worth with the PBGC premium payers picking up the excess liability. In some cases, such employers have terminated their plans and immediately set up new plans paying identical benefits with the exception of an offset for the benefits payable by the PBGC under the terminated plan. Warnings about the termination insurance program were sounded in 1974 before ERISA was enacted, and now they have come to fruition.

In addition, present law allows a controlled group of corporations to "spin-off" a subsidiary and its related pension liabilities, thus removing the controlled group from the reach of the PBGC in the event the subsidiary terminates its plan. In other cases, the liability to the PBGC can be increased dramatically when a company sells its assets and transfers its pension liabilities to a buyer which is financially weaker than the seller.

The potential exposure to the single-employer program of the "abuses" described above has been estimated by the PBGC to be, at a minimum, over $8 Billion. Given the shortcomings of present law the policy of title VI of the bill states that it is therefore desirable:

(1) to modify the current funding and termination insurance provisions relating to single-employer pension plans in order to increase the likelihood of protecting plan participants against the loss of nonforfeitable benefits, and

(2) to modify the termination insurance program for single-employer pension plans by changing the insurable event from the time of plan termination to the time of the liquidation of the plan sponsor in order to place primary emphasis on plan continuation and contain program costs within reasonable limits.

Insurable Event

Under the bill, the insurable event triggering PBGC benefit guarantees is changed from plan termination to the time, as determined by the PBGC, of the liquidation or partial liquidation of the contributing sponsor of the plan. The PBGC is authorized to restore part or all of a plan to the contributing sponsor when circumstances warrant, and by this means may insure only part of a plan in the event an employer is only partially liquidated.

A plan is defined to be "terminated" as a result of (1) the adoption of a plan amendment providing that participants receive no service credit (for any purpose) after the termination date; (2) the plan becoming a defined contribution plan; (3) the withdrawal of all employers from a multiple-employer plan; or (4) the occurrence of an insurable event. Upon plan termination in the first two circumstances, the obligation of the employer is not to the PBGC but is to continue to fund over a period of 15 years any unfunded vested liabilities under the plan. This provides significant relief to employers who under present law must pay over to the PBGC in a lump sum the amount of any unfunded liability for guaranteed-vested benefits under the terminated plan.

Benefit Guarantees and Premiums

The bill makes no changes in the current levels of benefit guarantees or premiums related to single-employer plans, but does change the procedure for making future changes in guarantees and premiums consistent with the procedure applicable to multiemployer pension plans.

In order to encourage the establishment and continuation of small plans, an exemption from the premium requirement, but not coverage, is made available for plans having fewer than 35 participants. This will eliminate PBGC reporting and collection costs for nearly two-thirds of existing plans.

Benefit guarantees would be triggered under a plan at the time of an insurable event as defined earlier. However, only those benefits which are nonforfeitable at the time of plan termination would be guaranteed. Also, the phase-in of benefit guarantees would be related to the date of plan termination. Additionally, benefit improvements adopted or effective subsequent to other events, such as a title 11 proceeding or a receivership involving the plan sponsor, will not be guaranteed when such events result in the occurrence of an insurable event.

Employer Obligations

If an insurable event (as defined above) occurs in connection with a single-employer plan, the employer's liability to the PBGC is computed in a similar manner as under present law as an amount equal to the current value of guaranteed plan benefits over the current value of plan assets (net of estimated PBGC administrative expenses and including recoverable unpaid contributions). The employer remains obligated for any unpaid contributions to the plan up to the time an insurable event occurs.

While the bill removes the present law 30 percent of net worth cap on an employer's liability, the claim of the PBGC has been reduced significantly. Under present law the PBGC's claim on employer assets is in the form of a lien, and in the case of bankruptcy or insolvency the lien has a priority status in the same manner as a federal tax lien. Under the bill, PBGC's claim is reduced to that of a general unsecured creditor. The lessening of PBGC's claim to general unsecured creditor status is considered appropriate since (1) the more rapid funding of plans required under the bill will serve to reduce the risk and exposure to the PBGC, and (2) the provision will treat employers under single-employer plans consistently with employers under multiemployer plans (in which case the PBGC is also a general unsecured creditor).

The PBGC's claim arises upon an insurable event or may be triggered earlier at the time of the filing of any petition in connection with a bankruptcy, insolvency, or assignment for the benefit of creditors which subsequently leads to an insurable event. A claim to the PBGC applies to (1) each contributing sponsor of a plan, (2) each a member of a control group of which a contributing sponsor was member at the time the claim arises, and (3) each trade or business which was a member of a control group of which a contributing sponsor was a member within five years prior to the time the claim arises (15 years if membership in the control group was changed for purposes of avoiding liability for plan benefits). The definition of "control group" under the bill means a group of trades or businesses under common control (requiring an interest of 50 percent or more).

To protect the single-employer program against unnecessary loss, the bill also provides that in the event of a change in a plan's contributing sponsor, the prior sponsor (including each trade or business which was a member of a control group of which such prior sponsor was a member within five years of the change) will be held liable to the PBGC if an insurable event occurs within 15 years from the date of the change. The 15-year period may be reduced depending on the level of the plan's unfunded accrued benefits at the time of the change (e.g. sale of the business). Of course, the prior contributing sponsor and control group members are only liable to the extent the new contributing sponsor (and related control group members) is unable to satisfy the PBGC claim. Three exemptions apply which serve to limit the obligation of prior contributing sponsors and control group members. Those exceptions apply when:

(1) the net tangible assets of the new contributing sponsor and all trades or businesses under common control with such contributing sponsor, determined immediately after the change of contributing sponsor, are greater than the net tangible assets (determined immediately before the change of contributing sponsor) of the prior contributing sponsor and all trades or businesses under common control with the prior contributing sponsor within five years of the date of the change, or

(2) immediately after the change of contributing sponsor, the net tangible assets of the new contributing sponsor are greater than the value of the unfunded vested benefits under the plan, determined under regulations prescribed by the PBGC, or

(3) immediately before the change of contributing sponsor, there were fewer than a total of 35 participants in all single-employer plans to which contributions were made by or on behalf of the prior contributing sponsor or any trade or business which was a member of a control group of which the prior contributing sponsor was a member.

Special rules also apply in the case of a multiple-employer plan (i.e. a single-employer plan in which all contributing employers are not within the same control group). An employer withdrawing from a multiple-employer plan would be required to pay withdrawal liability to the plan over a 15-year period in order to amortize an equitable share of the plan's unfunded vested benefits attributable to the employer's participation. The amount of withdrawal liability would be offset by the amount of unfunded vested benefits transferred to another plan maintained by the withdrawing employer.

Funding Changes

In many cases the current minimum funding standards for single-employer plans have been inadequate to contain the growth of unfunded pension liabilities within supportable levels, thereby unnecessarily increasing the risk to the insurance program and encouraging financially ailing plan sponsors to limit their liabilities by terminating their plans. The bill modifies the current ERISA standards in order to strengthen plan funding and reduce the ultimate cost of the single-employer programs to PBGC premium payers.

The bill incorporates a variation of the funding standards originally adopted by the House of Representatives when ERISA was first considered in 1974. Under this provision, if the current net charges to the Funding Standard Account amount to less than the first year payment which would be required to amortize over 15 years the plan's unfunded vested benefits, then the latter amount would constitute the new net charges. This new "15-year rolling test" would not be made applicable until the sixth plan year for new pension plans.

In addition, in order to prevent plans from becoming insolvent, the bill requires plans to make contributions sufficient to enable a plan to pay benefits when due.

As described earlier, "terminated" or "frozen" pension plans would be required to amortize plan unfunded vested benefits over a period of 15 plan years from the time of termination.

Terminated Sufficient Plans

The current administration by the PBGC of terminated pension plans with sufficient assets to pay benefits is both costly and unnecessary. Since the passage of ERISA, almost 96 percent of all terminated plans have been found to be sufficient. The bill will reduce PBGC administrative expenses by permitting sufficient plans to certify to the PBGC that all vested benefits have been satisfied.

Senator **Nickles**. Our next witness today will be Jeff Hart, who is director of the Association of Private Pension and Welfare Plans, Washington, D.C.

Welcome, Mr. Hart. I might advise the rest of our guests that I did take an extensive amount of time with Congressman Erlenborn, but it is my expectation to move a little more rapidly with the balance of our guests so we can conclude in the not too distant future.

Mr. Hart, welcome; we appreciate your statement. Who do you have with you today?

STATEMENT OF JEFF R. HART, EXECUTIVE DIRECTOR, ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS, INC., WASHINGTON, D.C., ACCOMPANIED BY GARY QUINTIERE, LEGAL COUNSEL

Mr. **Hart**. Senator, I have with me this morning Gary Quintiere; he is a member of the association's legal counsel, Miller & Chevalier.

Senator **Nickles**. We welcome you and will be happy to have your comments.

Mr. **Hart**. Senator, the association appreciates this opportunity to present its views on S. 1541. We consider this bill to be the most comprehensive and thoughtful effort in ERISA reform yet to be introduced, and we are fully supportive of the underlying purposes of the bill.

Now, my primary purpose in testifying today is to underscore the broad and firm support within the employee benefits community for the objectives sought by the bill. Our association represents the full spectrum of employers, plan sponsors and professionals involved with the administration of every type of private pension and welfare plan being maintained in America today.

Of our over 600 member firms, over half of them are plan sponsors. Large, medium and small employers are equally represented through design. Our remaining member firms are those that support plan sponsors in the delivery of benefits. Our professional service members represent by far the most significant joining together of active pension expertise in the Nation. Collectively, these firms are involved with the overwhelming majority of the Nation's private pension plans.

Our employer members, large and small alike, have expressed clear support for the underlying purposes of S. 1541. Every element of our professional service membership has expressed similar support. I can say unequivocally that any contention that the private pension industry would prefer to see only narrow segments or only a single title of S. 1541 advanced at this time is neither informed nor accurate.

Now, as demographic and other pressures begin to bear down even more heavily on our social security system, increased dependence on individual retirement savings and private pension plans is both inevitable and desirable.

We do not, as an association, delude ourselves by believing that the meaningful reform of ERISA will be a simple or expeditious affair. There is a complex and arduous task before all of us in this effort.

However, if the American worker is to look forward in confidence to a retirement of adequate security, it is a path that we must begin to travel now. We are most encouraged that S. 1541 is omnibus in its approach and that this subcommittee is giving it early attention. To be meaningful, ERISA reform must be broad.

While statistics demonstrate that the private pension system has been enormously successful, there is no question that the Nation can and must do more to strengthen that system. In this regard, ERISA reform, particularly S. 1541, can generate sounder growth trends in the private pension system.

The nature of new plan formation since ERISA has been altered considerably. This is due in no small measure to the fact that many of ERISA's well-intentioned remedial provisions have proven both redundant and are unnecessarily burdensome, particularly for defined benefit plans.

We recognize that the majority of individuals who are not covered by the private pension system are employed with small employers, many of whom are just beginning operations. For economic reasons, it would be difficult for many of these employers to adopt retirement plans for their employees. However, because of impediments under ERISA, employers are faced with additional burdens which further dampen their incentive to adopt retirement plans for their employees.

In order to achieve optimum coverage, unnecessary ERISA impediments must be eliminated, and this bill would be a large step in that direction.

While the association would like to submit its full technical comments for the record in the interests of time, in closing I would like to comment just briefly on those provisions of the bill that are of great importance and strongly supported by the association.

Title II, which would increase IRA limits to $2,000, and also allow the deductability of voluntary contributions to qualified plans, is made unnecessary because of the provisions contained in the Tax Act. However, title II does contain an important feature that was not in the Tax Act, and that is deductability for mandatory contributions in qualified plans.

This association and a number of other organizations, labor and business alike, building up to the markup of the Tax Act, stressed strongly that mandatory deductability was an important element in spurring private savings. And I think while the business community is going to make a good-faith effort to go with voluntary deductability, when you talk about retirement savings on a grand scale over time, mandatory deductability becomes very important.

Now, title III, for the most part, makes much-needed improvements in reporting and disclosure rules. I cite a few that will be particularly helpful; first, a rule which permits certain severance pay plans and supplemental pension plans, the benefits of which are paid out of an employer's general assets, to be classified as welfare plans rather than pension plans, and therefore be removed from the restrictive regulatory regime which blocks the provisions of such plans to needy employees. This rule would correct the incomplete provision in the Multiemployer Pension Plan Amendments Act of 1980 which was intended to achieve the same result.

Secondly, under reporting and disclosure, a rule which requires accountants and actuaries to rely on each other's opinion so as to eliminate the rendering of duplicative opinions which do nothing more than increase the cost of plan administration.

Under the participation, vesting and funding provisions of title III, there are four provisions that I would like to cite specifically; first, a rule which would permit the eligibility period for plan entry to be counted on a plan year basis rather than on an employment year basis; secondly, a rule which would permit reasonable changes in actuarial assumptions associated with computing optional forms of benefit not to be treated as reduction of a participant's accrued benefit; thirdly, rules which would improve and make more workable the infinitely complex qualified joint and survivor annuity requirements; and lastly, a rule which would permit actuaries to make funding recommendations based upon future benefit changes.

Now, moving to title IV, which would, in essence, generally amend the Internal Revenue Code, this particular title contains some features of its own which are very important. As Representative Erlenborn mentioned, it opens up and provides a blueprint for dialogue in the integration area.

I think, in a relative sense, this is by far the most complex technical area, and we would like to submit our technical comments at a later date. But we are very encouraged that the bill does provide this platform for dialogue.

Secondly, in title IV of importance is the codification of the 4/40 vesting safe harbor. If there is one area that is a detriment to the small employer, it is the uncertainty of how the Internal Revenue Service will apply its discrimination procedures that can lead to disqualification. Whether it is 4/40 or some other safe harbor, there needs to be some kind of certainty that a small employer can enjoy when he initially is setting up a pension plan and maintains it during those formative years.

Now, title V introduces an individual retirement payroll deduction program for employees not covered by pension plans. The association feels that this title at this time is premature. We would like to see the Tax Act that was just passed be given a chance to work, in that it did open up for every individual the opportunity, if they are financially able otherwise, to set up an individual retirement account.

We would prefer to see that act applied here, where somebody with a free and individual choice can set up an IRA, as opposed to having a title that would bring employers in under compulsory conditions to assist them in doing that to some extent.

Now, at present we do not have a position on those provisions of the bill which would create a single agency. The membership here, frankly, is split. Many people see, as Representative Erlenborn mentioned, the other titles of this bill hinging very critically on the creation of the EBA. Others are concerned that it could generate a period of disruption; that perhaps the lack of shared jurisdiction would introduce some policy emphases that are not there now and that are held in some degree of check or balance.

And then there is also some question as to whether the consolidation could occur in what would ultimately involve a net cost savings as far as Government support to the program.

But I do want to underscore that for the EBA, what I am saying not be construed as opposition. I think we have some of the best technical people in the association that have worked under ERISA working on this problem, and we are endeavoring to complete our study on it so that we can have a position before the record of these hearings closes.

Senator, I thank you for the opportunity to appear here, and the association is ready and remains anxious to help you in advancing this most important ERISA reform effort.

Senator NICKLES. Thank you, Mr. Hart. We welcome your support and also your comments and the expertise that your association has been able to put together. I would like to ask you a couple of questions. You mentioned a few things that I would like to clarify.

First, I would like to ask—of your members and the members that have plans—are the majority of those plans defined contribution or defined benefit plans?

Mr. HART. The vast majority are defined benefit plans, although I might add that when you get to the professional service side of the membership, which is about half of our membership, you are talking about either a direct or indirect involvement in plans that affect about 40 million workers, in total. So, there is a fair amount of involvement in defined contribution plans.

But our employer members, by and large, are those employers that have defined benefit plans.

Senator NICKLES. Of the employers that have vast numbers of employees and the ones that have the large plans with the very large assets—I think you mentioned that you have big companies, little companies, and so on—are the majority of those defined benefit plans?

Mr. HART. They are.

Senator NICKLES. I have a couple of comments on some of the recommendations that were mentioned regarding participation, vesting and funding. You mentioned that you were very supportive of the changes we made that would have plan entry on a plan year instead of a calendar year, is that correct?

Mr. HART. That is correct.

Senator NICKLES. How does that simplify it for a small employer? How is that going to be easier on him, contrasted to a calendar year basis?

Mr. HART. Gary has worked on this specific problem, and it is primarily an administrative burden.

Mr. QUINTIERE. It allows the employer to monitor all of his employees on the same plan year, rather than have to watch when each one enters employment and count 1 year from that time. So, it simply would allow the employer 1 year to watch, and it will make the administration of the plan much easier.

Senator NICKLES. I agree; I am supportive of that. The particular pension plan that we had in our company has a beginning date, an initiation date, or whatever it is called, of December 20. We have wrestled with that date or burdensome time in trying to either move that back or forward, and we have found it just unbelievably burdensome in trying to make some change. So, I appreciate your comment.

A couple of other things: Would you care to elaborate on this idea of the actuarial equivalent, that actuarial assumptions associated with computing optional forms of benefit are not to be treated as reductions of participants' accrued benefit?

Mr. HART. Go ahead, Gary.

Mr. QUINTIERE. Well, I would say we are strongly in favor of that amendment, Senator. The problem now is that a defined benefit plan simply promises the normal forum, and actuaries from time to time——

Senator NICKLES. Straight-life annuity, beginning at retirement?

Mr. QUINTIERE. Straight-life annuity, age 65. If the plan also offers optional forums, it is incumbent upon the plan actuary to make certain assumptions as to what the actuarial equivalent of those optional forums would be. The actuary should have the freedom to make those assumptions, and the plan should be able to make those assumptions without the specter of an act hanging over its head.

Senator NICKLES. Let us say that if an individual is to retire at age 65 with a $300-a-month retirement, and that is the straight-life benefit, and if they wanted to receive an optional form of retirement benefit, whether it be joint survivor, whether it be a——

Mr. QUINTIERE. Or a lump sum.

Senator NICKLES. Or a lump sum. Would they receive the actuarial equivalent of whatever that is at 65?

Mr. QUINTIERE. That is right; that is right. The actuarial equivalent at that time would be the same for all retirees, so all retirees would be treated evenhandedly.

Senator NICKLES. Isn't that actually to the retiree's or employee's advantage because that enhances the opportunity of employers of providing for them a greater variety of income?

It may be possible that a particular individual may be desirous of a lump sum or may be desirous of a 10-year certain or a joint and survivor—it may mold into his particular life span or plan differently than saying, automatically, straight-life annuity.

Mr. QUINTIERE. That is correct, Senator; it does.

Mr. HART. Senator, in that area, the particular part of ERISA that this would rectify really does cut across the grain of present value theory. To the extent that it does, it forces the employer to limit the options, and, as you mentioned, the employee is ultimately hurt.

Senator NICKLES. We had wrestled with that in our company because we wanted to provide the maximum. We wanted to take the present value and be able to distribute that money in any way that the employee would desire. The tables are almost unlimited in the various varieties, and it can be designed or scheduled for an employee without a great deal of expense. ERISA does require us to be in contact with actuaries, and those computations are not that difficult.

A couple of other quick questions. Is it correct that actuaries must use different assumptions for collectively-bargained and non-collectively-bargained plans to compute future benefit changes? Do you happen to know the answer to that?

Mr. QUINTIERE. I would rather not answer that question because I am not an actuary. I know one of the actuarial problems in the area of collectively-bargained plans is that the bargaining agreements will promise benefit increases off into the future, and there is a restriction right now on the actuary recommending increased funding for the plan to account for the benefit increases which will kick in, in the future.

I think this bill will permit the actuary to fund right now for a benefit increase which is designed to come in, in the future.

Senator NICKLES. To fund immediately, or to amortize that funding over a period of time?

Mr. QUINTIERE. Well, you know, you would amortize it over a while, but you could begin the funding now.

Mr. HART. I think the Multiemployer Amendments Act, generally speaking, brought the funding standards of the multiemployer plans generally in sync with the single-employer plans.

The way ERISA stands now, this bill would really not change the basic premise of an actuary establishing an asset target that has to be funded over time. Now, the actuary can choose one of six different methods to shape that funding curve to meet that asset target over time, and that is usually where you get the interaction between the employer's needs and the actuary—the shape of that curve.

But S. 1541 would enable the actuary to have more flexibility in choosing those various methods, although the total area under that curve—the total dollars set aside over time—would be the same under any of the differing methods.

Senator NICKLES. Mr. Hart, you mentioned also the strong support of an omnibus bill and reluctance, I think, to take single titles. There has been some legislation that has been introduced that does specifically mention one title. We did introduce an omnibus bill, and a fairly comprehensive bill.

Would you care to state your belief in why you think it is important to go with a more comprehensive approach?

Mr. HART. One of the things that the association has been devoting an awful lot of resources to in the last couple of years was to look at Titles I, II and III of ERISA as they now stand, to try and gauge what practitioners were having problems with out there—things that could be changed to facilitate new plan growth without really, in any meaningful way, degrading protection for participants, just eliminating redundancy and some of the uncertainty, and codifying some of the regulations that are hanging there with an air of uncertainty behind them—if you will, a general cleanup.

Now, we have seen in past transactions the very obvious, commonsense cleanup of ERISA, if you will, that could spur new plan formation. It continues to be deferred for one reason or another, and it all tends to come back to termination insurance. And as you have indicated, that is the subject of another hearing, but we think it is a real disservice to the American worker to continue to set aside the refinement of titles I, II, and III while we try and work through the termination insurance problems.

Those problems are severe and clear and have a lot of immediacy. But I think we need to find a way to fix ERISA. We have been looking at titles I, II, and III for 7 years now, and the types of changes that you are trying to seek here really are not controversial beyond the symbology involved.

So, that is why we very much favor an omnibus approach. We could be playing with the concept of termination insurance for many, many years, but these need to be fixed. I think they are important to all of us—labor, business and the like.

Senator NICKLES. I very much appreciate your comments, gentlemen, and also your support of this legislation. Thank you.

Mr. HART. Thank you, sir.

Mr. QUINTIERE. Thank you.

[The prepared statement of Mr. Hart follows:].

APPWP
THE NATIONAL ASSOCIATION
FOR EMPLOYEE BENEFITS

STATEMENT
OF
JEFF R. HART
EXECUTIVE DIRECTOR
ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS, INC.
TO THE
COMMITTEE ON LABOR AND HUMAN RESOURCES
SUBCOMMITTEE ON LABOR
NOVEMBER 4, 1981

ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS, INC.
1725 K STREET, N.W., SUITE 801/WASHINGTON, D.C. 20006/(202)659-8274

I am Jeff R. Hart, Executive Director of the Association of Private Pension & Welfare Plans, Inc. (the "Association") and I am accompanied today by Gary Quintiere, a member of the Association's legal counsel, Miller & Chevalier.

The Association appreciates this opportunity to present its views on S.1541, the Retirement Income Incentives and Administrative Simplification Act of 1981. The Association has as its primary goal the strengthening of the private benefits systems of this country -- and we consider this bill to be the most comprehensive and thoughtful effort in ERISA reform yet to be introduced. We are fully supportive of the underlying purposes of S.1541 and are most encouraged by the Chairman's expressed intent to refine the bill as the merits of its current construction are weighed carefully during and pursuant to these hearings.

My primary purpose in testifying today is to underscore the broad and firm support within the employee benefits community for the objectives sought by this bill. The Association represents the full spectrum of employers, plan sponsors, and professionals involved with the administration of every type of private pension and welfare plan being maintained in America today.

Since 1978, the Association has diligently pursued the goal of establishing an active organization, structured to gauge accurately the pulse of its diverse members and represent appropriately the consensus of their views. Within our membership we maintain a nationwide Legislative Council of some 150 representative members which sets, by vote, the broad legislative and regulatory policies to be sought by the Association in improving the environment of the private benefits system. Within the parameters set forth by this Council, we maintain several Legislative Committees comprised of highly-specialized experts in the benefits field, which develop detailed policy recommendations in specific issue areas.

Given our goals, our method of formulating policy objectives, and our broadly representative membership, the Association is fast becoming the principal voice of the employee benefits industry in this Nation. Today, the Association is comprised of over 600 members and is growing. Approximately half of our member firms are plan sponsors. The plan sponsor segment of the membership is kept balanced -- to represent large, medium, and small employers equally. Just as AT&T, Mobil and United Technologies are supporting members, so are Mrs. Baird's Bakeries, Paducah Newspapers, and the Bank of Yazoo City. Maintaining a representative cross section of employers is of vital importance to our formulation of policy recommendations -- for the benefits policy needs of the very large and very small employer often vary significantly, and appropriate policy balances must be sought if the private pension system is to be kept strong.

The Association's remaining 300 members are comprised of firms that support plan sponsors in the delivery of benefits: insurance companies, accounting firms, law firms, banks, investment companies, actuarial and benefit consulting firms, and others. The professional service segment of the membership represents, by far, the most significant joining together of active ERISA expertise in the Nation. Collectively, these professional service organizations are involved with the overwhelming majority of America's private pension plans.

I have gone to some length in outlining the Association's purpose and membership because, as I stated in the beginning, my primary purpose today is to make clear the broad support within the employee benefits community for the objectives sought by S.1541.

While we will submit our detailed technical comments for the record on all titles of the bill, I will today confine my remarks to the general.

Our employer members -- large and small alike -- have expressed clear support for the underlying purposes of S.1541, particularly in regard to the main objectives of those titles which are the subject of today's hearings. Every element of our professional service membership has expressed similar support. I can say unequivocably that any contention that the private pension system would prefer to see only narrow segments, or only a single title, of S.1541 advanced at this time is neither informed nor accurate.

During the years immediately ahead, America's Social Security dilemma will become practically and politically inescapable. As demographic and other pressures begin to bear down even more heavily on our Social Security system, increased dependence on individual retirement savings and private pension plans is both inevitable and desirable. It is incumbent, therefore, upon Congress to seek the legislative and regulatory environment that will enhance the private pension system, while strengthening incentives for individual retirement savings.

We do not delude ourselves by believing that the meaningful reform of ERISA will be a simple or expeditious affair -- there is a complex and arduous path before all of us in this effort. However, if the American worker is to look forward in confidence to a retirement of adequate security, it is a path that we must begin to travel now.

We are most encouraged that S.1541 is "omnibus" in its approach and that this Subcommittee is giving it early attention. To be meaningful, ERISA reform must be broad. We will benefit little, if at all, from the piecemeal amendments of expediency. And the indecisiveness of delay is a luxury that our Social Security problems will not permit us to enjoy.

The issue of ERISA reform has been addressed on numerous occasions since the enactment of ERISA in 1974. While statistics demonstrate that the private pension system has been enormously successful, there is no question that the

Nation can and must do more to strengthen that system. In this regard, ERISA reform, particularly S.1541, can generate sounder growth trends in the private pension system.

Studies developed by the Employee Benefit Research Institute, a non-profit and non-partisan educational organization, show that the private pension system covers some 75 percent of the ERISA workforce (i.e., individuals who have attained age 25 but not over 65, have completed one year of service and do not work part-time, adjusted for agricultural and self-employed persons). I mention here that the Employee Benefit Research Institute has been engaged in very sound pension research in recent years. The Institute, which does not take policy positions, and its work are commended to the attention of this Subcommittee. The rapid expansion of private pension coverage has occurred over a relatively short span of time. In 1950, 9.8 million individuals participated in plans. In contrast, by 1979, 35.2 million were participating in private plans. This is a growth in private pension coverage of 263% as compared to a labor force increase of only 89%. The nature of new plan formation since the passage of ERISA has been altered considerably. This is due in no small measure to the fact that many of ERISA's well-intentioned "remedial" provisions were redundant and unnecessarily burdensome -- particularly for defined benefit plans.

We recognize that the majority of individuals who are not covered by the private pension system are employed with small employers, many of whom are just beginning operations, and therefore are paying relatively low wages. For economic reasons, it will be difficult for many of these employers to adopt retirement plans for their employees. However, because of impediments under ERISA, which S.1541 would largely eliminate, employers are faced with additional burdens which further dampen their incentive to adopt retirement plans for their employees. In order to achieve optimum coverage, unnecessary ERISA impediments must be eliminated.

Another reason for the disillusionment of potential plan sponsors is their perception that ERISA requires compliance with a needless and complex series of rules resulting in inefficiency, waste and duplication of effort. This occurs not only in plan administration but also in the compliance and enforcement functions overseen by the bureaucratic agencies which administer the law. The most recent example of what causes this negative perception of ERISA is the GAO report on Management of Private Pension Plan Data. We believe that S.1541 holds the potential to reverse these negative perceptions concerning ERISA and will result in a more positive attitude toward the establishment and maintenance of private retirement plans.

The bill, if enacted, would go a long way towards eliminating these problems caused by ERISA and, therefore, will strengthen the private pension system in this country. In addition, it would enhance many of the positive features of ERISA. Among these welcome changes will be the reform of the prohibited transaction rules. Our Association is most pleased that these rules will be part of the reform bill, but we will not comment on them today since they will be the subject of later hearings. We are also pleased that the Subcommittee will be considering the reform of single employer termination insurance at a later date.

I now want to comment on those important segments of this bill which are the subject of today's hearings.

Title II would increase the IRA limits to $2000 or 100% of compensation, whichever is lesser, and would permit similar contributions to be made by persons participating in qualified pension plans. Those changes have already been made by the Economic Recovery Tax Act of 1981 (ERTA) and are therefore unnecessary here. In addition, however, Title II would permit qualified pension plan participants to obtain tax deductions for mandatory as well as voluntary contributions to their plans. This feature was not part of ERTA and is one change which we would strongly endorse. In our judgment, the Congress would greatly stimulate employee contributions to pension plans if the artificial and needless ERTA distinction between mandatory and voluntary employee contributions were eliminated. As we stated prior to ERTA, deductibility solely for voluntary contributions is inadequate to spur the magnitude of retirement savings possible under constructive tax policy.

A number of our members have already seen that the lack of a deduction for mandatory contributions has caused confusion and problems for employers which maintain plans providing mandatory contributions. In the future, when the deduction under ERTA will be effective, employees will be faced with the difficult choice between making deductible voluntary contributions and non-deductible mandatory contributions. To the extent these employees chose to cease making non-deductible mandatory contributions, the qualified status of the employer's plan is jeopardized. These problems will become of immediate concern beginning in 1982 and Congress must address this area as soon as possible.

Title III would, for the most part, make much needed improvements in the reporting and disclosure rules, the participation, vesting and funding provisions, and the complex and often inconsistent fiduciary requirements, which were all part of the original ERISA. Some of the highlights in these areas which we support are --

- Reporting and Disclosure --

  1. a rule which permits certain severance pay plans and supplemental pension plans, the benefits of which are paid out of an employer's general assets, to be classified as welfare plans rather than pension plans and therefore be removed from the restrictive regulatory regime which blocks the provision of such plans to needy employees. This rule would correct the incomplete provision

in the Multiemployer Pension Plan Amendments Act of 1980 which was intended to achieve the same result.

2. a rule which requires accountants and actuaries to rely on each others opinion so as to eliminate the rendering of duplicative opinions which do nothing more than increase the cost of plan administration.

o Participation, Vesting and Funding --

1. a rule which would permit the eligibility period for plan entry to be counted on a plan year basis, rather than on employment year basis.

2. a rule which would permit reasonable changes in actuarial assumptions associated with computing optional forms of benefit not to be treated as reduction of a participant's accrued benefit.

3. rules which would improve and make more workable the infinitely complex qualified joint and survivor annuity requirements.

4. a rule which would permit actuaries to make funding recommendations based upon future benefit changes.

o Fiduciary --

1. a rule which clarifies the obligations and liabilities of fiduciaries for the actions and omissions of their co-fiduciaries.

2. a rule which would facilitate the return of a mistaken contribution to contributors to such plans.

Title IV would amend the Internal Revenue Code so as to include many of the same ERISA changes made by Title III. In addition, Title IV includes some very important provisions which this Association would strongly endorse. For example, it would allow employees who receive lump sum distributions from qualified pension plans to roll-over into IRAs the employee portion of that distribution as well as the employer portion. Such a provision would induce employees to save more for their retirement and, therefore, take some of the burden off the already over-strained Social Security system. Another provision of Title IV would permit the tacking of participation time in a predecessor plan or a plan of a controlled group of corporations. This rule is necessary because the IRS is currently applying a restrictive interpretation of the Code which results in the deprivation to a participant of capital gains benefits which he already earned.

Finally, another example of a rule which we would favor is that which makes the "4-40" vesting standard a "safe-harbor" to a discrimination challenge. There is a long and tortured history behind this provision which I will not relate to you now. Rather, it suffices to say that the Association would applaud the establishment of the 4-40 safe-harbor rule and accordingly, we urge you to adopt it.

Title IV also attempts to address the nagging issues relating to the integration of the Social Security retirement program with a privately sponsored benefit plan. Integration is perhaps the most complicated of the pension issues and, therefore, I will refrain from offering a detailed account of our technical recommendations at this time. Those will be set forth in a submission which we will make to this Subcommittee before the record of these hearings closes. I will say, however, that the Association welcomes a fresh review of the integration issue and believes that it is necessary that it be addressed at this time.

Title V introduces an individual retirement payroll deduction program for employees not covered by pension plans. Essentially, this program would compel an employer to implement a payroll witholding plan so that his employees may conveniently make contributions to an IRA. We do not favor this program at the present time. Beginning in 1982, any employee by independent and individual choice, whether or not covered by a pension plan, will be permitted to save up to $2000 per year toward retirement simply by making a contribution to an IRA. We understand that Title V attempts to strike a compromise between the needs of the uncovered workforce and their employers by sharing the burdens of coverage. While we applaud any effort to avoid mandatory coverage, we are not confident that this compulsory payroll deduction program would solve the problem.

Moreover, it is possible that the experience after ERTA, when coupled with deductibility for mandatory contributions, would make this program unnecessary. Consequently we feel it is premature to consider Title V at this time.

We do not at present have a position on those provisions of the bill which would create a single ERISA agency, the Employee Benefits Administration (EBA). We have reservations that the EBA, as contained in S.1541, can be installed without substantial disruption of procedures already in place. We are also concerned that the creation of the EBA could hold the potential to disrupt the policy balances that are inherent in the current shared jurisdictions. We also have questions as to the administrative feasibility of improved operations, without increased costs, under EBA consolidation. However, I want to emphasize that our Association is not against the concept of the single agency as a general principle -- and, in spite of our current reservations, we can see some potential for benefit under the concept. One of our Legislative Committees is currently studying the single agency question in some detail, and we will, of course, make such recommendations available to this Subcommittee as soon as they are approved by our Board.

This concludes my prepared remarks. The Association appreciates the opportunity to appear before this Subcommittee and is willing and anxious to assist the Subcommittee's work in advancing this important ERISA reform effort.

Senator NICKLES. Our next witness today is Robert Georgine who is president of the Building and Construction Trades Department, AFL-CIO.

Mr. Georgine, welcome again before this committee. It is good to see you again.

STATEMENT OF ROBERT A. GEORGINE, CHAIRMAN, NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS, ACCOMPANIED BY JACK CURRAN, LEGISLATIVE DIRECTOR; AND PETER SCHMIDT, LEGAL COUNSEL

Mr. GEORGINE. It is always good to see you, Mr. Chairman.

Senator NICKLES. We would be happy for you to begin. Would you introduce your people who are with you, please?

Mr. GEORGINE. I have with me, Mr. Chairman, Jack Curran, our legislative director, and Peter Schmidt, one of our legal counsels.

Senator NICKLES. Thank you.

Mr. GEORGINE. I appreciate very much the opportunity to testify before the Subcommittee on Labor with respect to S. 1541, the Retirement Income Incentives and Administrative Simplification Act.

I am appearing here this morning in my capacity as chairman of the National Coordinating Committee for Multiemployer Plans. The coordinating committee is a nonprofit corporation organized to represent the interests of the 8 million participants in collectively bargained multiemployer plans.

The coordinating committee has over 100 affiliates, consisting of collectively bargained multiemployer pension and welfare funds and related national and international unions in many different industries.

Over 3 million workers participate in multiemployer plans affiliated with the coordinating committee. The committee, as currently structured, represents the continuation of a less formal organization developed during the deliberations of the Employment Retirement Income Security Act of 1974, and since that time we have been continuously and actively engaged in the development of regulations and legislation in the employee benefit plan area.

The coordinating committee was closely involved in last year's multiemployer legislation which, among other things, significantly reduced certain artificial incentives for withdrawal from multiemployer plans.

S. 1541 is a major piece of ERISA legislation with extremely broad scope. It incorporates certain changes of which the coordinating committee has been supportive and others as to which we have serious objections or reservations.

Our basic position, however, turns not so much on the merits of the particular provisions of this bill, but rather on the firmly held belief that now is not an appropriate time for congressional consideration of legislation modifying ERISA.

Last year's multiemployer legislation was itself a sweeping change to which the pension community is only now beginning to adjust. No more than a handful of the necessary implementing regulations have been proposed. Misunderstanding, apprehension and other concerns in some quarters have resulted in court challenges and demands for modification or repeal.

We believe that plans, contributing employers and the Pension Benefit Guaranty Corp., all need time to make the adjustments necessary for rational implementation of this complex legislation. We believe that the statute offers plans and the PBGC sufficient flexibility to make these adjustments.

Many of us remember a similar situation in the period immediately following the enactment of ERISA in 1974. Court challenges and demands for repeal were heard from many quarters at that time as well.

While certain aspects of ERISA and its administration do present problems that need working through, few would now deny that protection of the pension and other benefit rights of our working men and women took a giant step forward with passage of that landmark legislation.

Pension funds and the benefits they provide are playing an increasingly important role in our economy and in the economic security of our citizens. The need to protect the well-being of such plans is evident.

In short, we fear that the enactment of additional complex ERISA legislation at this time would create a chaotic and controversial atmosphere. In such an atmosphere, the rational implementation of new legislation, as well as legislation already on the books, would be difficult.

Given the misunderstanding and apprehension existing in some quarters, we also fear that premature adjustments to the multiemployer legislation may be offered in the Congress. As the members in this committee know better than I, it is frequently difficult to prevent the addition of unwanted amendments with effects beyond the scope of the bill to which such amendments are added.

If I may, Mr. Chairman, I would like to point out the experiences that we had last year with the enactment of the multiemployer pension plan amendments. It was very difficult to get all of the industry and all of the multiemployer pension universe to agree on what the final proposal of that legislation was, and we only did that by a great deal of work and compromise on all sides of the fence.

And even after we had consensus of all of the interested parties and we had all made the compromises that were necessary to go forward together, even then we had five or six nongermane amendments tacked on to that bill, and that is what we are concerned about it.

So, Mr. Chairman, even though this bill has many provisions that we could support on their merits alone, we do not favor going forward on this legislation at the present time. At another time, our position could be different, and in that vein I would like to mention several provisions of the bill that we believe could be improved.

I would also ask that the record include a more detailed technical statement that I have brought with me today.

We take great interest, Mr. Chairman, in section 3302 of the bill, which relates to permitted suspensions of benefits—an issue of vital importance to multiemployer plans. In many industries, there is a real problem with employees who retire under the plan and then return to work with a noncontributing employer. If a plan pays benefits in such cases, it is, in effect, subsidizing the competition of its contributing employers, thereby undermining its contribution base. It is imperative that such plans be able to apply effective suspension rules in these cases.

Another problem arises in industries where intermittent employment is the norm. In such industries, an inactive period of several months or more does not always mean that a participant who has reached normal retirement age has actually retired. Plans should not be required to pay benefits during periods of inactivity if the participant still works on a regular basis.

Many plans have found that suspension for longer than the actual period of reemployment is required. A large plan can hope to monitor reemployment of retirees adequately only if it can rely on reporting from the retirees themselves. Unless there is an adequate deterrent to false reporting, a significant percentage of reemployment situations will escape discovery.

The difficulties experienced to date with proposals on benefit suspension cause us to be wary of leaving the scope of permitted benefit suspensions to Labor Department regulations. Any legislation on this subject should therefore explicitly sanction the ability of the plans, with or without Labor Department regulations, to adopt reasonable benefit suspension procedures.

Section 3308 of the bill addresses another issue of concern to many multiemployer plans. This section would provide that a multiemployer pension plan need not award credit for hours of service for which the participant's employer does not make the required contributions to the plan. However, the bill would not resolve this question in the context of defined contribution plans, where the problem is even more acute.

Defined contribution or individual account plans provide for fixed employer contributions, established through collective bargaining, which are credited to the individual accounts of participants. Credits to the accounts of participants are based upon the amounts actually contributed to the plan, so that participants generally receive no credit for delinquent contributions except to the extent such contributions are subsequently collected.

The Internal Revenue Service is considering issuing a ruling to the effect that a defined contribution plan would not meet the requirements of Code section 401 unless the plan credited the accounts of participants for all required contributions, whether collected or not. Such a ruling could result in the disqualification of most multiemployer defined contribution plans.

The proposed IRS position would disrupt collective bargaining relationships and would be detrimental to the hundreds of defined contribution multiemployer plans negotiated to provide for the financial security of working men and women.

These plans operate with relatively low administrative costs and have been successful in achieving low delinquency rates. Any legislation in this area should specify that participants' accounts need be credited only for contributions actually received by the plan.

Finally, Mr. Chairman, we oppose the requirement set forth in section 6303 of the bill that unfunded, vested liabilities be amortized over a 15-year period, rather than the 30- or 40-year periods provided by present law. Such a requirement would be highly inappropriate for multiemployer plans.

Under the 1980 multiemployer legislation, such plans are already required to meet a comparable standard known as the minimum contribution requirement. This provision already requires multiemployer plans to fund the vested benefits of persons in pay status over a 10-year period and the vested benefits of all others over a 25-year period.

Superimposing an additional requirement that vested benefits be amortized over a 15-year period would be both unnecessary and complicating. Such a requirement could be severely disruptive to labor-management relations and the entire collective bargaining process.

In conclusion, Mr. Chairman, there are some provisions in this bill as to which we have objections or reservations. There are others that the coordinating committee has supported and that we continue to believe in. For the reasons I have described, however, we oppose further ERISA legislation at this particular time.

Thank you very much for the opportunity to appear before you.

Senator NICKLES. Thank you, Mr. Georgine.

We have with us, and we appreciate the presence of our chairman, Senator Hatch. He has a statement which I would like to have entered in the first part of the meeting at the appropriate time, and I believe he has a question before he has to take off.

Senator HATCH. Welcome to the committee, Bob. We always enjoy having you here. I just have one question.

I recently offered a bill, S. 1678. Now, this bill amends ERISA to exempt residential mortgages from the prohibited transaction rules if the mortgages are adequately secured and bear a reasonable rate of interest.

Could you give me your opinion on that? What it would do would allow you to use your pension funds to help residential housing, where today they can be used for casinos and shopping centers. We feel it might be a way to bring the housing industry out of some of the doldrums it is in, while at the same time putting downward pressure on these interest rates that are causing so much difficulty throughout our society, and certainly to every working man and woman of America.

Mr. GEORGINE. Well, Senator, God knows the housing industry needs some help.

Senator HATCH. It sure does.

Mr. GEORGINE. Of course, you know, my basic position is that I do not think we ought to move any legislation at this point. But the basic concept of your legislation, I think, is a very good one; it is one that we have looked for for a very long time and have supported in the past and would support if it moves on through.

I would say that there are some fiduciary aspects of it that I have some question about. I do think that we have to look at what is a reasonable rate of return, and I am not quite so sure that a reasonable rate is the average return that we have received in the last 10 years or so; you know, some of them have been a negative return.

Senator HATCH. Well, that is just to set a base or a floor.

Mr. GEORGINE. Yes.

Senator HATCH. In other words, the fund manager would have to make that determination, and I would agree with you. I do not think it is the lowest rate; I think it has got to be a reasonable rate for those funds to be operable. But keep in mind that you would be able to foot them at long-term interest rates, which would certainly save a lot of managerial expense, among other things.

Mr. GEORGINE. Basically, I think that the concept is a good one. I applaud you for thinking about it and trying to do something about the housing industry, and with those certain reservations, we would probably support it.

Senator HATCH. Thank you. It is always good for you and me to agree on something.

Mr. GEORGINE. That does not happen very often. [Laughter.].

Senator HATCH. That is right. I am trying to get you to come around. [Laughter.]

I might add that he is trying to get me to come around pretty hard, too.

Thank you, Mr. Georgine; we appreciate your leadership in this.

Mr. GEORGINE. Thank you.

Senator NICKLES. Thank you, Senator Hatch; we appreciate your comments.

Senator HATCH. Thank you, Mr. CHAIRMAN.

Senator NICKLES. I did not say your bill; I said your comments. [Laughter.]

Senator NICKLES. Mr. Georgine, we have heard testimony earlier today, and we will have additional testimony from the pension community, which I think endeavors to increase the quality of pensions for all people—certainly, the employees and the workers, union and nonunion participants of pension plans, and it has been favorable to the omnibus type of legislation.

We were hoping that you and the coordinating committee and the building trades would also be supportive of the thrust of our bill. With that comment, I think we can agree on many items that, as you have mentioned, you have been supportive of in the past, and the coordinating committee, also, in the past.

Is it not true that many of the things that are encompassed in the legislation are supported by the coordinating committee?

Mr. GEORGINE. That is certainly true, Senator.

Senator NICKLES. But the timing is more your opposition?

Mr. GEORGINE. The timing is the problem.

Senator NICKLES. You are not necessarily in opposition to the legislation; you are dubious and leery. And I understand that quite well; I share that concern with you.

Does your real opposition to the ERISA legislation at this time stem from your fear of any amendments to the multiemployer law that was passed last year?

Mr. GEORGINE. That is one of our major fears. That is not the only one, but that is one of the major fears. There are people, of course—you and Congressman Erlenborn have not done that, but there are people who want a second bite at the apple after they have agreed on what should have been in the legislation. They now want to come back in what they consider to be a more favorable Congress.

Senator **Nickles**. We have purposefully left off the multiemployer title IV section of the bill. There is legislation, as I am sure you aware, that deals with that and would delete it. We have planned hearings in 1982 sometime on Senator Hatch's bill.

It is our intention, and I want you to be aware of it, that we have every intention of separating the two. We realize the negative aspects that could be attributed to the multiemployer insurance provisions, and they could muddy a very good piece of legislation that is generally supported by almost everybody—the entire pension community, and business, labor and employees—trying to come up with some needed amendments to well-intentioned legislation in 1974 which is in need of some revision.

It is our intention to move ahead with this legislation, independent of title IV, and we would appreciate your support. We also appreciate your comments. I think you had mentioned supportive things of the general thrust of the legislation, and had a few questions and possibly problems with certain parts of it.

As I have stated in the past, we are very receptive to individuals and groups who have a knowledge in this area and who think we can make it better; we want your input. On the question of timing, as I stated in my opening statement, I think the time is now. I am afraid that if we wait, we are going to allow several problems to compound, and many of the people that will be penalized will be these employees that we are trying to help.

I think there are good things for the employees and workers of America and it is important that it be acted upon. I also think that it is important that we separate the issues. That is the thrust and the direction that we will take, knowing of some of the people—and not that I am not supportive of their efforts on title IV multiemployer, but I think that they will support our efforts to keep them separate.

We will work in that vein, and work full speed ahead to try to come up with a good piece of legislation. We would hope that you and the people that you have with you that have expertise in this area would keep the communication lines open.

Mr. **Georgine**. Well, we thank you for that opportunity, Senator, and although I have expressed grave reservations about legislation being passed at this present time, I know full well through experience that just because I do not want legislation to pass does not mean it is not going to pass.

So, we will work with you, especially on those issues which we feel very seriously about it, and will continue to work with you and your committee on all of these issues. We just hope that any legislation that may move forward will not be overloaded with the kinds of amendments that would really cause havoc rather than assistance.

Senator **Nickles**. I appreciate that. With that, we will look forward to working with you. Thank you very much.

Mr. **Georgine**. Thank you.

[The prepared statement of Mr. Georgine follows:]

October 30, 1981

Statement of Robert A. Georgine, Chairman, National Coordinating Committee for Multiemployer Plans

I appreciate very much the opportunity to testify before the Subcommittee on Labor with respect to S. 1541, the Retirement Income Incentives and Administrative Simplification Act.

I am appearing here this morning in my capacity as Chairman for the National Coordinating Committee for Multiemployer Plans. The Coordinating Committee is a non-profit corporation organized to represent the interests of the eight million participants in collectively bargained multiemployer plans. The Coordinating Committee has over 100 affiliates, consisting of collectively-bargained, multiemployer pension and welfare funds, and related national and international unions, in many different industries. Over three million workers participate in multiemployer plans affiliated with the Coordinating Committee.

The Coordinating Committee as currently structured represents the continuation of a less formal organization developed during the deliberations on the Employee Retirement Income Security Act of 1974. Since that time we have been continuously and actively engaged in the development of regulations and legislation in the employee benefit plan area. The Coordinating Committee was closely involved in last year's multiemployer legislation, which, among other things, significantly reduced certain artificial incentives for withdrawal from multiemployer plans.

S. 1541 is a major piece of ERISA legislation with extremely broad scope. It incorporates certain changes of which the Coordinating Committee has been supportive and others as to which we have serious objections or reservations.

Our basic position, however, turns not so much on the merits of the particular provisions of this bill, but rather on the firmly held belief that now is not an appropriate time for congressional consideration of legislation modifying ERISA. Last year's multiemployer legislation was itself a sweeping change to which the pension community is only now beginning to adjust. No more than a handful of the necessary implementing regulations have been proposed. Misunderstanding, apprehension and other concerns in some quarters have resulted in court challenges and demands for modification or repeal. We believe that plans, contributing employers, and the Pension Benefit Guaranty Corporation all need time to make the adjustments necessary for rational implementation of this complex legislation. We believe that the statute offers plans and the PBGC sufficient flexibility to make these adjustments.

Many of us remember a similar situation in the period immediately following the enactment of ERISA in 1974. Court challenges and demands for repeal were heard from many quarters at that time as well. While certain aspects of ERISA and its administration do present problems that need working through, few would now deny that protection of the pension and other benefit rights of our working men and women took a giant step forward with passage of that landmark legislation. Pension funds and the benefits they provide are playing an increasingly important role in our economy and in the economic security of our citizens. The need to protect the well-being of such plans is evident.

In short, we fear that enactment of additional complex ERISA legislation at this time could create a chaotic and controversial atmosphere. In such an atmosphere the rational implementation of new legisation, as well as legislation already on the books, would be difficult. Given the misunderstanding and apprehension existing in some quarters, we also fear that premature adjustments to the multiemployer legislation may be offered in the Congress. As the members of this Committee know better than I, it is frequently difficult to prevent the addition of unwanted amendments with effects beyond the scope of the bill to which such amendments are added.

Mr. Chairman, even though this bill has many provisions we could support on their merits alone, we do not favor going forward on this legislation at the present time. At another time, our position could be different. In that vein, I would like to mention several provisions of the bill that we believe could be improved. I would also ask that the record include a more detailed technical statement I have brought with me today.

We take great interest, Mr. Chairman, in section 3302 of the bill, which relates to permitted suspensions of benefits -- an issue of vital importance to multiemployer plans. In many industries, there is a real problem with employees who "retire" under the plan and then return to work with a noncontributing employer. If a plan pays benefits in such cases, it is in effect subsidizing the competition of its contributing employers, thereby undermining its contribution base. It is imperative that such plans be able to apply effective suspension rules in these cases.

Another problem arises in industries where intermittent employment is the norm. In such industries, an inactive period of several months or more does not always mean that a participant who has reached normal retirement age has actually retired. Plans should not be required to pay benefits during periods of inactivity if the participant still works on a regular basis.

Many plans have found that suspension for longer than the actual period of reemployment is required. A large plan can hope to monitor reemployment of retirees adequately only if it can rely on reporting from the retirees themselves. Unless there is an adequate deterrent to false reporting, a significant percen[illegible] reemployment situations will escape discovery.

The difficulties experienced to date with proposals on benefit suspension cause us to be wary of leaving the scope of permitted benefit suspensions to Labor Department regulations. Any legislation on this subject should therefore explicitly sanction the ability of plans, with or without Labor Department regulations, to adopt reasonable benefit suspension procedures.

Section 3308 of the bill addresses another issue of concern to many multiemployer plans. This section would provide that a multiemployer pension plan need not award credit for hours of service for which the participant's employer does not make the required contributions to the plan. However, the bill would not resolve this question in the context of defined contribution plans, where the problem is even more acute.

Defined contribution or "individual account" plans provide for fixed employer contributions, established through collective bargaining, which are credited to the individual accounts of participants. Credits to the accounts of participants are based upon the amounts actually contributed to the plan so that participants generally receive no credit for delinquent contributions except to the extent such contributions are subsequently collected.

The Internal Revenue Service is considering issuing a ruling to the effect that a defined contribution plan would not meet the requirements of Code section 401 unless the plan credited the accounts of participants for all required contributions, whether collected or not. Such a ruling could result in the disqualification of most multiemployer defined contribution plans.

The proposed IRS position would disrupt collective bargaining relationships and would be detrimental to the hundreds of defined contribution multiemployer plans negotiated to provide for the financial security of working men and women. These plans operate with relatively low administrative costs and have been successful in achieving low delinquency rates. Any legislation in this area should specify that participants' accounts need be credited only for contributions actually received by the plan.

Finally, Mr. Chairman, we oppose the requirement, set forth in section 6303 of the bill, that unfunded, vested liabilities be amortized over a fifteen-year period, rather than the thirty-or forty-year periods provided by present law. Such a requirement would be highly inappropriate for multiemployer plans. Under the 1980 multiemployer legislation, such plans are already required to meet a comparable standard known as the minimum contribution requirement. This provision already requires multiemployer plans to fund the vested benefits of persons in pay status over a ten-year period and the vested benefits of all others over a twenty-five-year period. Superimposing an additional requirement that vested benefits be amortized over a fifteen-year period would be both unnecessary and complicating. Such a requirement could be severely disruptive to labor-management relations and the entire collective bargaining process.

In conclusion, Mr. Chairman, there are some provisions in this bill as to which we have objections or reservations. There are others that the Coordinating Committee has supported and that we continue to believe in. For the reasons I have described, however, we oppose further ERISA legislation at this time.

Thank you for this opportunity to appear.

Technical Comments on S. 1541

Submitted by the National Coordinating Committee for Multiemployer Plans

The National Coordinating Committee for Multiemployer Plans (the "Coordinating Committee") is a nonprofit corporation which was organized to represent the interests of the eight million participants in multiemployer plans. The Coordinating Committee represents over 100 affiliates including major international unions, national pension and welfare plans, and local multiemployer trusts.

As the Chairman of the Coordinating Committee has testified, we believe that this is not an appropriate time for legislation modifying ERISA. There are, however, certain changes which we would like to see incorporated should legislation in this area go forward at another time. These changes would take account of the special nature and problems of multiemployer plans.

I. Section 3101: Supplemental Pay Plans

By treating certain supplemental pay arrangements as welfare plans instead of pension plans, Section 3101 of the bill would exempt such arrangements from the provisions applicable only to pension plans. To take account of the special problems of multiemployer plans, any legislation in this area should be modified as described below.

First, the restriction that benefits be paid entirely out of the general assets of the employer is unworkable in multiemployer situations. It is the nature of most industries served by multiemployer plans that workers move from employer to employer, making it impossible for any given employer to maintain a plan providing meaningful benefits. In these industries, the only feasible arrangement is for plans to be funded through a multiemployer trust. Contributions to such trusts can then be made at a designated rate pursuant to collective bargaining agreement. Such contributions go to provide benefits for all eligible participants, regardless of who their employers may have been. Another reason for a trust is that the contributions made during a contract period may well exceed benefits paid, creating a reserve. There must be some entity to hold such reserves for the following period. It should be stated, in legislative history or otherwise, that use of a trust in such manner is a proper purpose under section 501(c)(9) of the Internal Revenue Code.

Second, we believe any legislation should grant flexibility in the establishment of limited-duration reduction-in-force arrangements. From time to time, employers contributing to multiemployer plans may find it useful to effect a desired or necessary reduction in force by providing supplementary payments to those employees who retire within a prescribed and limited period of time. Such an arrangement may offer a lifetime payment in addition to the regular pension to those who retire within the two-year or three-year contract period. Under present law the ERISA vesting requirements for pension plans may pose questions about these arrangements. We believe these questions should be resolved in favor of such arrangements. The limited duration of such supplemental offers would serve to guarantee that they would not be used to avoid the basic goals of ERISA.

Third, it would be desirable for participants to be advised of the limitations of any payments promised or received under such arrangements, including the fact that they are not covered by the vesting provisions of ERISA. The Coordinating Committee therefore suggests a requirement for such notice in any legislation.

The regulation on supplemental pay plans proposed by the Labor Department pursuant to the 1980 multiemployer legislation is unduly restrictive in other respects that should be corrected in any new legislation on this subject. For example, the employer's commitment should not be limited to one year in multiemployer contexts. Contribution commitments under a multiemployer arrangement may run for a two-year or three year contract period, or longer, and the commitment to pay benefits may last for more than one year. Also there is no reason to prohibit supplemental payments to persons who have been retired for less than two years. If this section of the bill were enacted in its present form, it could conceivably be interpreted as approval of all other aspects of the Labor Department's proposed regulation.

II. Section 3207: Summary Annual Report

ERISA section 104(b)(3) currently requires a plan administrator to furnish to each participant and to each beneficiary receiving benefits a summary annual report within 210 days after the close of the plan's fiscal year. Section 3207 of the bill would amend ERISA section 104(b)(3) to require a plan administrator to post the summary annual report (including a statement of the participants' rights to the annual report, a summary plan description, and other plan information) at the principal work sites of participants. The Secretary of Labor would be directed to issue regulations providing for alternative methods of publication including, but not limited to, distribution of the summary information through company or union newsletters. In addition, this section of the bill would statutorily limit the maximum amount that a plan could charge for a complete copy of the annual report to $10.00.

The Coordinating Committee recommends that any legislation in this area incorporate the following changes to take account of the special nature and problems of multiemployer plans.

First, this section of the bill as written would apply only to pension plans. The term "employee benefit plan" should be used in lieu of "pension plan" so as to include welfare plans within the coverage of this section.

Second, direct distribution of the summary report by multiemployer plans to participants should remain as a statutory alternative method of distribution so that multiemployer plans that prefer to continue distribution directly to participants need not wait for Labor Department regulations in order to do so.

Third, for multiemployer plans in some industries, such as the construction industry, posting at the principal work sites may not be a practical method of distribution because of the short-term nature of many projects. In the construction industry the local union office or hiring hall is the focal point of employment activity because it is generally through the local union office or hiring hall that workers are assigned or referred to employers and projects. The posting of summary annual reports at the local union office or hiring hall would be comparable to posting at the principal work sites. Accordingly, this section of the bill should specifically authorize, for multiemployer plans, posting at the local union office or hiring hall as an alternative method of distribution. We note that proposed ERISA section 111(a)(3)(B) contained in section 3212 of the bill provides for the posting of certain required information at local union offices. Further recognition of the legitimacy of such a distribution method is contained in section 2520.104b-1(3)(iii) of current Labor Department regulations which provides for the maintenance of plan documents at local union offices.

Finally, we oppose the statutory $10.00 limit on charges for complete copies of the annual report. We believe that the current ERISA section 104(b)(4) restriction on charges is adequate. Given the effects of inflation, the setting of a maximum charge is better suited to the regulatory process.

III. Section 3208: Simplification of Notice to Interested Parties

The Coordinating Committee does not oppose simplification of the notice process, but, at least in terms of the timing and publication of the notice, we believe that the current Treasury regulations[1/] are adequate and that these sections of the bill would represent neither a simplification nor an improvement of existing law. These sections would expand the time period during which the notice must be posted. We are concerned that the 60 day requirement would create unwarranted procedural problems for plans and would cause unproductive delays in obtaining an IRS review and determination.

We are further concerned that the alternative methods of publication of the notice provided for in the current Treasury regulations be preserved and legislatively sanctioned. Those regulations have worked well and represent a reasonable balance between the rights of interested parties and the needs of plans. The alternative publication methods provided for in the current regulations are consistent with the intent of sections 3208, 4202, and 3207 of the bill to simplify the notice and disclosure requirements.

IV. Section 3212: Alternative Methods of Disclosure

This provision would add a new section 111 to ERISA, prescribing a detailed procedure for multiemployer plans to use a special alternative means of meeting certain ERISA disclosure obligations, if the plans choose to do so. The procedure would authorize multiemployer plans to furnish information to plan participants by providing the documents to their employers, who would in turn make the distribution directly to the covered employees.

Under current law and regulations, plans may distribute disclosure material to participants by means that are reasonably calculated to ensure actual receipt of the information by the participants. In appropriate situations, multiemployer plans are able to satisfy this requirement with the cooperation of the participants' employers in ensuring adequate direct distribution. It does not appear to be either necessary or advisable to change the law in this regard specifically for multiemployer plans.

V. Section 3302: Suspension of Benefits

Section 3302 of the bill would allow plans to suspend benefits to workers who have not retired but who continue to work on an irregular basis, and would specifically include self-employment as work subject to the suspension rules. It would also permit plans, as a limited deterrent to retirees who fail to report reemployment, to suspend benefits for a period, not to exceed 12 months, in addition to the period of reemployment.

Because of the special nature of multiemployer plans, the ability of plans to adopt reasonable suspension of benefit rules is a subject of vital concern. The Coordinating Committee has made a number of submissions and has met with Labor Department officials many times on the Department's proposed regulations on this subject. Specific concerns we have with this section of the bill include the following.

1. The Committee believes that any legislation amending section 203(a) should itself explicitly permit reasonable suspension rules, without requiring plans to wait for administrative regulations on the subject. Any regulations promulgated thereunder should be for the purpose of facilitating reasonable plan rules rather than circumscribing the intended policy of Congress.

2. Any amendment of section 203(a) should include an amendment of section 203(a)(3)(B)(ii) to provide as follows:

> "(ii) in the case of a multiemployer plan, in the same industry, or the same trade or craft, and in the same geographic area."

The need for this amendment is described below.

Multiemployer plans are generally based on collective bargaining agreements covering certain employees in a particular trade or craft, or in a particular industry. However, multiemployer plans do not necessarily cover employees in a particular craft or trade within a particular industry. It is possible to interpret the current provisions of ERISA section 203(a)(3)(B)(ii) to require that a retiree be engaged in both the industry and trade or craft in which he was formerly engaged, before a plan can suspend benefits. Such a requirement would make it almost impossible for multiemployer plans to determine whether suspension of benefits is warranted.

The work coverage of a multiemployer plan is generally defined either by the product produced, or by the nature of the service provided. In the former case, workers are covered without regard to their trade or craft. For example, a plan maintained for hard rock miners may encompass laborers, carpenters, electricians, maintenance workers, truck drivers, and other skilled and unskilled classes of workers. The designation of trade or craft is essentially meaningless in this context because the multiemployer plan covers any trade or craft which occurs in the industry.

On the other hand, many multiemployer plans are based on a particular craft. Such multiemployer plans cover carpenters, plumbers, sheet metal workers, electricians, laborers, plasterers, musicians, etc. These plans often embrace all persons employed in a particular craft within the scope of a collective bargaining agreement, regardless of the product or service sold by the employer. Thus, a covered carpenter, plumber, or electrician may be employed in original construction, construction alteration, building maintenance, or by almost any large employer in a variety of industries. For such "craft" multiemployer plans, the "industry" is irrelevant.

3. Any legislation in this area should explicitly permit multiemployer plans to recoup benefits improperly made to reemployed retirees, by offsetting future benefit payments to those retirees. Multiemployer plans should be permitted to recoup the full amount owed plus interest.

4. Multiemployer plans should be able to define the circumstances of reemployment justifying benefit suspension in the manner that most appropriately fits the situation faced by the plan. We regard a statutory or regulatory definition involving a certain number of hours of service as arbitrary in view of the differing factual contexts confronting plans.

5. Any suspension rules should permit multiemployer plans to suspend benefits for longer than the months of actual reemployment. Absent a plan's ability to do so, a retiree has no incentive to comply with suspension rules.

6. Any legislation in this area should make clear that suspension rules are not applicable to the employee who merely continues working for the same employer past normal retirement age. A contrary position, as may be endorsed by the Department of Labor regulations, would cause enormous financial and administrative burdens for multiemployer plans.

7. Any legislation in this area should make clear that suspension rules are not applicable to the employee who merely continues working past normal retirement age. The proposed Labor Department regulations may be read to endorse a contrary position.

8. In industries where intermittent employment is the norm, it should be made clear that an inactive period of several months or more does not mean that a participant of normal retirement age or older has actually retired. Plans should not be required to pay benefits during periods of inactivity if the participant still works on a regular basis.

VI. Section 3307: Years of Service, Years of Participation, and One-Year Break in Service at Seasonal Establishments

The bill would require plans in which a majority of employees are seasonal to use 500 hours, rather than

1,000 hours, for purposes of defining a year of service, and to substitute 250 hours for 500 hours in the definition of a break in service. The bill also defines "seasonal employee" and "seasonal establishment." A "seasonal employee" would be defined generally as any participant who works on a full-time basis less than 1000 hours in a year, and who is employed at a seasonal establishment. A "seasonal establishment" would be defined generally as an establishment at which employment is limited by regular and recurring climatic conditions directly and physically affecting the ability of the establishment to engage in its normal functions, and at which a majority of the employee-hours completed by participants in pension plans established or maintained by such employer is performed by participants who complete on a full-time basis not more than 1,000 hours of service during any 12-month period at that establishment.

The Coordinating Committee is very concerned about the broad definition of "seasonal establishment." Such a sweeping definition may subject industries and employers to treatment as seasonal where it would be quite inappropriate to do so. For example, it might be possible under the bill's definition to identify some parts of the construction industry as seasonal. The construction industry is not treated as seasonal in other contexts, and it would disrupt labor-management relations and the collective bargaining process to suddenly classify such industries as seasonal.

VII. Section 3308: Delinquent Contributions

Section 3308 of the bill addresses an issue of concern to many multiemployer plans. This section would provide that a multiemployer defined benefit pension plan need not award credit for hours of service for which the participant's employer does not make the required contributions to the plan. However, the bill would not resolve this question in the context of defined contribution plans, where the problem is even more acute.

Defined contribution or "individual account" plans provide for fixed employer contributions established through collective bargaining, which are credited to the individual accounts of participants. Credits to the accounts of participants are generally based upon the amounts actually contributed to the plan so that participants receive no credit for delinquent contributions except to the extent such contributions are subsequently collected. In an individual account plan, it is particularly difficult to see where the money required to give credit for contributions that are never received is supposed to come from.

The Internal Revenue Service is considering issuing a ruling to the effect that a defined contribution plan would not meet the requirements of Code section 401 unless the plan credited the accounts of participants for all required contributions, whether collected or not. Such a ruling could result in the disqualification of most multiemployer defined contribution plans.

The proposed IRS position would disrupt collective bargaining relationships and would be detrimental to the hundreds of defined-contribution multiemployer plans negotiated to provide for the financial security of working men and women. These plans operate with relately low administrative costs and have been successful in achieving low delinquency rates. Any legislation in this area should specify that participants' accounts in defined-contribution plans need be credited only for contributions actually received by the plan.

VIII. Sections 3310 and 4310: Alimony and Support Payments

The Coordinating Committee believes that any legislative clarification of the applicability of the ERISA and Internal Revenue Code anti-alientation provisions to state court domestic relation orders should include, in addition to the provisions in the bill, the following features.

First, any legislation should clarify that any non-participant awarded a portion of a participant's pension benefits under a state court order does not thereby become a plan participant for purposes of ERISA. Treatment as plan participants would impose unwarranted costs on plans in terms of, for example, additional termination insurance premiums and disclosure requirements. Given the high divorce rate in this country, the participant populations of plans could dramatically increase without corresponding gains in covered employment and contributions if those who receive a portion of a participant's benefits are themselves deemed to be plan participants.

Second, many state court orders specifically authorize the affected plan to deduct from the participant's benefits a reasonable administrative fee to cover the plan's cost of splitting the benefits and maintaining records on the person sharing the participant's benefit. Such administrative fees should be specifically authorized in any legislation on this subject.

IX. Section 3503: Refund of Mistaken and Certain Other Contributions

The Coordinating Committee opposes section 3503(c) of the bill. This section provides in part that any determination by a plan administrator of a multiemployer plan prior to the enactment of S. 1541 that a contribution or payment had been made by mistake of fact or law shall be considered to have been made on such date of enactment. The effect of this provision would be to reopen all past determinations with respect to return of contributions and payments. This would resurrect issues and decisions that parties have long since laid to rest. Undue pressures would be brought to bear on trustees regarding matters that were previously settled under existing statutory provisions.

X. Sections 6202 and 6303: 15-Year Funding

Finally, we oppose the requirement, set forth in sections 6202 and 6303 of the bill, that unfunded, vested liabilities be amortized over a fifteen-year period. Such a requirement would be highly inappropriate for multiemployer plans. Under the 1980 multiemployer legislation, such plans are already required to meet a comparable standard known as the Minimum Contribution Requirement or MCR. MCR already requires multiemployer plans to fund the vested benefits of persons in pay status over a ten-year period and the vested benefits of all others over a twenty-five-year period. The adequacy of multiemployer plan funding has thus been comprehensively dealt with in recent legislation. Superimposing an additional requirement that vested benefits be amortized over a fifteen-year period would be both unnecessary and complicating, such a requirement could be severely disruptive to labor-management relations and the entire collective bargaining process, and would, in every case, add an unnecessary administrative cost for plans.

Senator Nickles. For our next witness today, we have William Greenough, who is chairman of the Subcommittee on Retirement Policy for the Committee on Economic Development.

STATEMENT OF WILLIAM C. GREENOUGH, PH. D., CHAIRMAN, SUBCOMMITTEE ON RETIREMENT POLICY, COMMITTEE FOR ECONOMIC DEVELOPMENT, NEW YORK, N.Y.

Senator Nickles. Welcome, and we appreciate your interest, input and expertise in this field.

Dr. Greenough. Thank you, sir.

My name is William Greenough. I am the retired chief executive officer of TIAA-CREF. TIAA-CREF provides retirement plans for 3,500 educational institutions—colleges, universities, independent schools, and so on. I might drop in here a comment that 50 percent of our 3,500 institutions have fewer than 25 participants in the plans, and there is no problem.

Senator Nickles. Do you want to repeat that? Fifty percent——

Dr. Greenough. Of the 3,500 colleges, universities, and so on—educational institutions of various kinds—half of those, or 1,750, have fewer than 25 participants in the plan, and there is no problem administratively.

Senator Nickles. Thank you.

Dr. Greenough. Today, I am speaking for the Committee for Economic Development, which has recently completed a comprehensive statement of retirement policy, after 2 years of extensive study and investigation.

For the record, the CED is an organization of elected trustees—200 from business, industry and the top college people—Derrick Bok of Harvard, and so on—to study public issues very thoroughly, to chew them over in the board, and have the entire board take action, so that when we come before you, it is as a whole group having participated in a 2-year program.

I will speak briefly, but I do have a galley of the report that is just coming out and I would like to present it because I think it is highly relevant, and the supporting information for the record.

Senator Nickles. That is appropriate, and we would be happy to enter it into the record.

Dr. Greenough. Well, the CED trustees, after their deliberation, have concluded that the Nation's public and private retirement systems have an enormous but not yet really recognized impact on the current and future economic and social health of the Nation; the whole thing is tied in together.

This impact can be measured in the many trillions of dollars. Yet, unless broad changes are made in our means of providing for retirement income, we are headed for real trouble. Inflation alone has made the costs of providing retirement benefits a substantial burden on both the workers and the employers. This has been compounded by a social security system which potentially is unrealistically generous.

That is not a question of the whole social security system, which I consider one of the best social engineering jobs we have ever done. It is the running past the facilities for financing that is the problem, especially when declining birth rates and increasing longevity will make it impossible to support the current system in the long run, even if we do solve the system's short-run financing crisis. The simple fact is that the number of individuals who can support the system will be rapidly declining compared with the number of those who will get benefits.

So, the CED approach to pension policy recommends balanced attention to all three tiers—social security, private savings and private pensions. On social security, we have made a number of specific recommendations that address both the long-term and short-term viability of the OASDI funds.

Senator, we have presented these before the respective committees of Congress that have jurisdiction over the issue, and with a strong message of urgency that these be adopted as part of a comprehensive strategy, and not singularly and in isolation.

If I may interpose there, for example, to have an isolated vote on one segment, such as the so-called "taxing of social security benefits" that happened a couple of days ago, is the worst possible way to proceed in this area.

Rather than go into the various items on social security now, I have provided a paper on it, and the things that we have already provided to other committees. The point is that no contemplated solution to social security will succeed, in our view, unless it is coupled with efforts to increase personal savings and expand the availability of private pension plans. And this is precisely what your bill, S. 1541, attempts to accomplish.

As far as I know, this measure and its companion bill, H.R. 4330, introduced by John Erlenborn in the House, who testified this morning, are the only bills under consideration that recognize that unless we quickly move to expand the opportunity for business to adopt and employees to participate in strong, sound pension plans, we may be conferring future hardship on millions of younger Americans when it comes time for them to retire.

The potential for growth in private pensions is substantial. About 25 percent of current employees, full-time workers above age 25, are not now participants; in pension plans. A figure of 50 percent is frequently used, but it is wrong. Only 25 percent are working for companies that don't have plans in which they are participating or will be eligible, but 25 percent is still a large figure. Many of the plans that do exist are not designed to provide the amount of income we believe is necessary to provide for secure retirement.

Many employers, especially small employers, have no formal retirement plan at all, and the costs to small employers are such that it is difficult for them to start new plans. Public policy has done little to encourage small employers and their employees to develop individual saving plans for workers' retirement.

Indeed, with the enactment of ERISA, the Government temporarily reduced incentives, as you are very well aware and as was mentioned earlier by other witnesses. The number of new plans that were being created in the postwar period up until ERISA was increasing dramatically each year. Between 1972 and 1974, 52,000 new plans were established each year. This dropped very significantly between 1975 and 1977, after ERISA, to an average of only 15,000 plans, with only 3,500 in 1977.

Although the rate of creation of new plans has increased since 1978, especially for defined contribution plans, we do think it is necessary to expand private plans much more rapidly. A broadened private pension plan will have, in addition to providing expanded benefits, a significant social and economic impact.

The Labor Department's productivity figures, down again during the third quarter, are scary. Unlike social security, private pension plans directly expand capital supply of the sort that will be necessary to provide the growth in productivity and real income that is essential to the economic security of the Nation's elderly. This strengthening of the productive economy will also help to meet, in your words, Mr. Chairman, "the incredible demands we place" on the social security system.

Therefore, I want to state emphatically that a proposal such as S. 1541 is a critical element to a comprehensive, long-term solution to the Nation's retirement problems.

Now, without intending to detract from that support of the comprehensiveness of S. 1541—and I do emphasize it because so many testifiers will be talking about this or that or the other segment; your comprehensive thing is the way to do it—let me give a few examples of specific proposals we find good—ones that follow closely the CED recommendations. Noteworthy among them are the encouragements for personal savings for retirement and expansion of private pensions.

Regarding personal savings, we concur with the objective of S. 1541 to increase still further the limits of IRA and Keogh accounts. Recently enacted tax legislation meets much of the current need, but we urge Congress to consider a further expansion, should the experience with these provisions that have already been put in effect prove favorable.

As to private pension provisions, we enthusiastically support the changes designed to simplify ERISA reporting and other requirements, such as participation rules, requirements as to joint and survivor annuities, and the exemption of severance pay and supplemental adjustments.

A most helpful provision is to consolidate all Federal pension regulations under a single agency, such as an Employee Benefit Administration. The time for that has come, or came some time ago, if you will.

We also support changes in prohibited transactions that have already been mentioned this morning and that would provide trustees class exemptions and eliminate certain meaningless restrictions. These and other changes would help eliminate the disincentives to the adoption of new plans by small employers who have little resources.

We also enthusiastically support the provisions in the bill that allow employee contributions to a private pension plan to be deductible from taxable income. This provision will encourage greater growth in employer plans and the improvement of these plans through the joint effort of employers and employees; they can both contribute and enhance the incomes.

The resulting retirement benefits would, of course, be taxable. But, overall, this could have a very significant impact on the future growth of private pensions.

Now, although the CED has no specific position on this particular matter, I would like to comment on it; that is the one in your bill that excludes employers with fewer than 35 employees from the premium requirement of PBGC. This would mean that all other employers would have to defray the cost of their own insurance plans, plus the cost of all the plans with fewer than 35 participants.

Now, this kind of a provision is a self-destructive insurance proposal. So, what we ought to do is take a very hard look, I believe, at the actual insurance costs for small employers, and as to whether to continue the present premium charges to such employers or whether, since the individual amounts are small but the aggregate is large, efficiency would suggest that the government pick up the cost. The third alternative would be to provide for IRS collection of all premiums, then turning them over to the PBGC on all sized plans.

On the issue of vesting, CED does not recommend any changes in the current mandated standards. I emphasize "mandated" because voluntary movement downward in vesting is continuing.

I found my next paragraph fairly obtuse, so I will state it differently. My text was too detailed. What we are trying to say is that we believe the present ERISA provisions regarding disposition of vested benefits upon termination of employment should be required instead of voluntary. That is, pension plans should allow only very limited cash-outs; cash-outs destroy the purpose for why the plan was established, for each individual cashing out. And pension plans should be required to provide either for the departing worker to continue in his former plan, to shift funds to the new plan that he is going to—that would be with the consent of both employers—or roll the funds over into an acceptable annuity.

Now, you have already mentioned MUPS—a marvelous name. We are pleased that your bill does not include a proposal for a mandated universal pension system—MUPS. CED also opposes such a plan. Instead, we fully agree with the various provisions of S. 1541 mentioned above that are designed to encourage voluntary expansion of private pension plans.

Enough on details at this point, unless there are questions. The important fact is that you are looking at the issue from a comprehensive perspective. This warrants the plaudits of all others who are concerned about the ability of the nation to provide a decent standard of living for all retirees.

The fact is that most of our future long-term capital resources will have to come from a sound and growing pension system. Without it, we will most certainly suffer further decreased productivity and further lose our competitive position in the world economy.

We at CED have tried in our study to look at the close relationship between retirement policy and a sound, growing economy, and have concluded, pretty obviously, that you cannot have one without the other.

You are to be commended for bringing S. 1541 up for consideration, and I hope you succeed in convincing your colleagues that without a measure such as this, we will only be mortgaging the future well-being of millions of Americans.

Thank you, sir.

Senator NICKLES. Thank you, Dr. Greenough. We appreciate your comments and also the amount of study and input that the Committee for Economic Development has put into this very important field. I think it somewhat emphasizes the broad base of recognition of the need for the changes to be made, and also that we are not just talking about one group or a particular business group, but we are reaching a very, very broad spectrum of all Americans.

Also, I appreciate your comment, too, for successful retirement systems to be set up, which are also very, very parallel to that of our economy. The two go hand-in-hand, and probably neither can survive without the other.

You mentioned that the costs to small employers are such that it is very difficult for them to start new plans. What are the major costs? You mentioned that you had a lot of plans that are in groups that are smaller than 25.

What is the major cost of starting a plan for a small employer?

Dr. GREENOUGH. There are a number of them. First let me mention our plans for the colleges, where the vast majority of them are small plans, although we have very large plans, also—10,000 participants at the State University of New York, and so on. These plans are economical to manage because the small ones have exactly the same contracts for each individual participant as a teacher or a janitor at a large institution; it is that transferability and the fact that the central organization picks up all the problems with respect to reporting and the rest of it that we are allowed to under ERISA. Some of it, we were not allowed to under the law.

We picked up those costs and were able to share them clear across many, many plans. When you have an individual employer of 20 or 15 employees, he does not have that kind of a mechanism available to him.

Now, the bill suggests working on precisely that part of it—pattern plans, plans that are set up so that they can be replicated for many employers even though they are not, as in TIAA-CREF, in one system. The various reporting things—since we could do it across the board, there is very little cost. When an individual employer has to do it, it is very onerous under the ERISA arrangements.

And then there is just the problem of being sure they do not invest the money badly; "badly" not being naughtily, but against some fiduciary requirement of ERISA, or whatever. That adds all the way through to actuarial costs, investment costs, and the rest of it, which, when you are dealing with a very small plan, are impossible to handle. Your provisions will help to cover that.

Senator NICKLES. You note that the number of new plans being created dropped significantly after the enactment of ERISA. Do you attribute this to the passage of ERISA?

Dr. GREENOUGH. I attribute a fair amount of it—none of us can quite figure out how much—to ERISA. Certain things were happening in the economy, and plans had grown very rapidly in the past. That also was a factor, but there is no question in my mind but that some of that dropping was directly attributable to ERISA.

Senator NICKLES. Looking under defined benefit plans, in the period of 1971, 1972, 1973, and 1974, they averaged 22,000, 28,000, 33,000, and 32,000. And then in 1975, we see a drop of—this is under qualified, new plans—a drop to 15,000 in 1976, 4,000 in 1977, 6,000 in 1978. When you are up to 30,000 and then you are down to a few thousand, that is a dramatic shift.

We see some increase in 1979 and 1980, going up to 15,000 and then back up to 18,000. Do you have a particular reason for this, do you think?

Dr. GREENOUGH. Well, lots of employers, in my opinion, want retirement plans for employees. In the colleges, it is perfectly voluntary to set up a plan; a college does not have to establish one. Furthermore, every dollar put in by the college is a full dollar; they get no tax advantage other than what they have as a college for doing it. Yet, 99 percent of the colleges, purely voluntarily, and 99 percent of their employees have been at colleges with plans for many, many years. So, employers want plans.

The impatience over ERISA—"Darn it; all this paperwork, I cannot pick it up"—finally winds up with, "Well, I will set up a plan anyway, in spite of all that." So, my hope and expectation is that were the simplifications and other provisions of your bill to be passed, that that increase would go on apace.

Senator NICKLES. Just looking at the figures of comparison between defined benefit plans and defined contribution plans—and I will enter this table into the record—but it shows that prior to 1974, the number of defined benefit plans in almost every year was greater than the number of defined contribution plans.

However, since the enactment of ERISA, with the exception of 1975 where they are just about even, in every year since the enactment of ERISA there has been an explosion of growth in defined contribution plans in relationship to defined benefit plans. For 1980, there were 50,000 new defined contribution plans, as compared to 18,000 defined benefit plans.

Do you attribute a lot of that to ERISA?

Dr. GREENOUGH. Yes, unquestionably, a lot of it is attributable to ERISA. However, several things can be said. Both defined benefit and defined contribution plans are good. There is a lot of debate back and forth, but they are both good. One fits better in some places; the other fits better in others.

I happen to have lived in the area of defined contribution plans for colleges all my life. They are great, but so are the others. Now, there are certain problems that ERISA was trying to get at in defined benefit plans as to evaluation and as to protection of employees, where you do not have full funding behind a plan; you always do under a defined contribution plan. ERISA was trying to get at those.

ERISA and your bill should continue to give protection in those areas and to work on the funding, and so on. But they really did do it a little bit clumsily and had a little bit of overkill, and discouraged defined benefit plans. The protection devices overplayed the methods of protection, not the objective of protection. You can keep the same objective of protection and make the methods of achieving it more flexible.

The second thing, however, is that defined contribution plans fit admirably; they are simple to administer and easy on the vesting part—the person just walks off with a single contract—for the smaller employers.

The very large employers had pretty well set their plans in place by the early seventies, so that the area for expansion was highly likely to be with defined contribution plans. Those two things together resulted in that explosion.

Senator **Nickles**. I would agree with that. I think that is a good analysis of actually what has happened. The small employer, when he looks at the defined benefit plans and he has 20 employees and is thinking of developing a pension plan possibly for the first time, he weighs the two and looks at all the administration—the actuary that he needs to have and the reports, and so on. Then he compares it to setting up an IRA for his employees, or setting up a defined contribution or profitsharing plan.

Many opt for the much simpler plan. The second part of that is that the employers who have had defined benefit plans are looking to enhance retirement incomes; they are going to supplement those defined benefit plans with defined contribution plans.

Dr. **Greenough**. That is a good point which I did not mention.

Senator **Nickles**. Thank you very much, Mr. Greenough. We appreciate your comments and also the amount of homework that you and your group have put into this particular area.

Dr. **Greenough**. Thank you.

[The prepared statement of Dr. Greenough follows:]

For Release on Delivery
November 4, 1981

Testimony

of

WILLIAM C. GREENOUGH, Ph.D.

Chairman, Subcommittee on Retirement Policy
Committee for Economic Development

Trustee, TIAA-CREF
and
Chairman, CREF Finance Committee

on

Retirement Income Incentives

before

Subcommittee on Labor

Committee on Labor and Human Resources

United States Senate

November 4, 1981

Mr. Chairman, my name is William C. Greenough. I am the retired chief executive officer of TIAA-CREF. TIAA-CREF provides retirement plans for employees of some 3,500 colleges, universities, independent schools and related nonprofit research organizations and educational institutions. But today I am speaking as Chairman of the Committee for Economic Development's Subcommittee on Retirement which has recently completed a comprehensive statement on retirement policy after over two years of extensive study and investigation. CED is a business policy forum that involves the active participation of 200 of our nation's leaders in business and education. I will speak briefly this morning, but I have brought a galley of our report and a summary and documentation which I suggest are highly relevant to your deliberations and therefore I hope they can be included in the record.

CED's trustees have concluded that the nation's public and private retirement systems have an enormous but not yet recognized impact on the current and future economic and social health of the nation. This impact can be measured in the many trillions of dollars. Yet unless broad changes are made in our means of providing for retirement income, we are headed for real trouble. Inflation alone has made the costs of providing retirement benefits a substantial burden on both workers and employers. This has been compounded by a Social Security system which potentially is unrealistically generous. Declining birth rates and increasing longevity will make it impossible to support the current system in the long-run, even if we do solve the system's short-run financing crisis. The simple fact is that the number of individuals who can support the system will be rapidly declining compared with the number of those who will get benefits.

The CED approach to pension policy recommends balanced attention to all three tiers: Social Security, private savings and private pensions. On Social Secuirty, we have made a number of specific recommendations that address both the short-term and longer viability of the OASDI funds. We have presented these before the respective committees of Congress that have jurisdiction over the issue, and with a strong message of urgency that these be adopted as part of a comprehensive strategy, and not singularly and in isolation. Rather than go into these now, I have provided you with a paper that details our Social Security proposals and their projected associated cost savings.

The point is that no contemplated solution to Social Security will succeed, in our view, unless it is coupled with efforts to increase personal savings and expand the availability of private pension plans. And this is precisely what S. 1541 attempts to accomplish. As far as I know this measure and its companion bill, H.R. 4330 introduced by John Erlenborn in the House, are the only bills under consideration that recognize that unless we quickly move to expand the opportunity for business to adopt and employees to participate in sound and strong pension plans, we may be conferring future hardship on millions of younger Americans when it comes time for them to retire.

The potential for growth in private pensions is substantial, despite the expansion of participation in private pension plans in the last twenty years. More than 25 percent of full-time workers still do not participate in pension plans. Many of the pension plans that do exist are not designed to provide the amount of income we believe is necessary to provide for secure retirement. Many employers, especially small employers, have no formal retirement plan at all, and the costs to small employers are such that it is difficult for them to start new plans. Public policy has done little to encourage small employers and their employees to develop individual saving plans for workers' retirement. Indeed, with the enactment of ERISA, the government temporarily reduced the incentives, especially for small employers, to establish private pensions. Before ERISA, the net number of new private plans being created each year increased consistently; the annual average between 1972 and 1974 was 51,967 new plans. This dropped significantly between 1975 and 1977 (after ERISA) to an average of 15,009, with only 3,494 new plans created in

1977. Although the rate of creation of new plans has increased since 1978, especially for defined-contribution plans, we believe it is necessary to expand private plans much more rapidly. A broadened private pension system will have, in addition to providing expanded benefits, a significant social economic impact. The Labor Department's productivity figures, down again during the third quarter, are scary. Unlike Social Security, private pension plans directly expand capital supply of the sort that will provide the growth in productivity and real income that is essential to the economic security of the nation's elderly. This strengthening of the productive economy will also help to meet, in the Chairman's words, "the incredible demands we place" on the Social Security system. Therefore, I want to state emphatically that a proposal such as S. 1541 is a critical element to a comprehensive long-term solution to the nation's retirement problems.

Without intending to detract from our support of the comprehensiveness of S. 1541, let me give a few examples of specific proposals we find good, ones that follow closely the CED recommendations. Noteworthy are the encouragements for personal savings for retirement and expansion of private pensions.

Regarding personal savings, we concur with the objective of S. 1541 to increase still further the limits of IRA and Keogh accounts. Recently enacted tax legislation meets much of the current need, but we urge the Congress to consider a further expansion should the experience with these provisions prove favorable.

As to private pension provisions, we enthusiastically support the changes designed to simplify ERISA reporting and other requirements, such as participation rules, requirements as to joint and survivor annuities, and the exemption of severence pay and supplemental adjustments. A most helpful provision is to consolidate all Federal pension regulations under a single agency such as an Employee Benefit Administration. We support changes in "prohibited transactions" that would provide trustees class exemptions and eliminate certain meaningless restrictions. These and other changes would help eliminate the disincentives to the adoption of new plans by small employers who have little resources.

We also enthusiastically support the provisions in the bill that allow employee contributions to a private pension plan to be deductible from taxable income. This provision will encourage greater growth in employer plans and the improvement of these plans through the joint effort of employers and employees. The resulting retirement benefits would, of course, be taxable. But overall, this could have a very significant impact on the future growth of private pensions.

Although CED has no specific position on this matter, I am concerned with the provision that excludes employers with fewer than 35 employees from the premium requirement of the Pension Benefit Guarantee Corporation. This would mean that all other employers would have to defray the cost of their own insurance plus the cost of all the plans with fewer than 35 participants. This is a self-destructive insurance proposal. A study should be made as to the actual insurance cost for small employers, and as to whether to continue the present premium charges to such employers or whether since the individual amounts are small but the aggregate is large, efficiency would suggest that the government pick up the cost. Or, as a third alternative, provide for IRS collection of all premiums, then turning them over to the PBGC.

On the issue of vesting, CED does not recommend any changes in the current mandated standards.

Before concluding, let me mention two other areas. Under ERISA, an employer must allow vested benefits to be left in the original plan if an employee leaves before retirement. The employee under a defined benefit plan should have the option of transferring vested benefits into a successor plan, with consent of both plan sponsors, or alternatively to an IRA or life insurance annuity. This is a useful concept when a defined benefit plan is fully funded, although we recognize that there are difficult issues of valuation and equity when a plan is not fully funded. CED recommends cash withdrawals that a lifetime limit of $500 should be placed on at time of job changes.

We are pleased that this bill does not contain a proposal for a mandated universal pension system - MUPS. CED opposes such a plan. Instead, we fully agree with the various provisions of S. 1541, mentioned above, that are designed to encourage voluntary extension of private pension plans.

Enough on details at this time. The important fact is that you are looking at the issue from a comprehensive perspective. This warrants the plaudits of all of us who are concerned about the ability of our nation to provide a decent standard of living for our retirees. The fact is that most of our future long-term capital resources will have to come from a sound and growing pension system. Without it we would most certainly suffer further decreased productivity and further lose our competitive position in the world economy. We at CED have tried in our study to look at the close relationship between retirement policy and a sound growing economy and have concluded that you cannot have one without the other. You are to be commended for bringing S. 1541 up for consideration and I hope you succeed in convincing your colleagues that without a measure such as this we will only be mortgaging the future well being of millions of Americans.

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(Note: In the interest of economy, additional material supplied by Mr. Greenough including a publication entitled "Reforming Retirement Policies," a statement by the Research and Policy Committee of the Committee for Economic Development, September 1981, was retained in the files of the committee where the material may be researched upon request.)

Senator NICKLES. Our next two witnesses will be in the form of a panel: Robert James, who is vice president, finance/treasurer, for Chemtech Industries in St. Louis, Mo., and he will be representing Compensation & Capital, Inc.; also Morton Harris, who is president of the Small Business Council of America, from Columbus, Ga.

Which one is Robert James?

Mr. JAMES. I am.

Senator NICKLES. And your name?

Mr. ROENISCH. I am Mr. Roenisch; I am his actuary.

Senator NICKLES. OK; good. You do not have any trouble keeping busy.

Welcome, gentlemen.

STATEMENT OF ROBERT L. JAMES, VICE PRESIDENT, FINANCE/TREASURER, CHEMTECH INDUSTRIES, INC., ST. LOUIS, MO., REPRESENTING COMPENSATION & CAPITAL, INC., CHICAGO, ILL., ACCOMPANIED BY DAVIS H. ROENISCH, ACTUARY, COMPENSATION & CAPITAL, INC.; AND MORTON A. HARRIS, PRESIDENT, SMALL BUSINESS COUNCIL OF AMERICA, INC., COLUMBUS, GA., A PANEL

Mr. JAMES. Yes, sir, I will be very pleased to lead.

My name is Robert L. James. I am vice president, finance/treasurer, of Chemtech Industries, Inc., a manufacturing corporation located in St. Louis, Mo. Chemtech Industries has a defined benefit pension plan covering 253 active employees and 35 terminated vested and retired members. We appreciate the opportunity to testify in favor of the provisions of S. 1541, and commend the efforts of you, Senator Nickles, and Senators Hatch and Wallop to simplify this area of the law.

More specifically, we wish to wholeheartedly endorse the provisions in title III. For example, section 3104 to permit the benefit payments to commence at the beginning of a calendar month, section 3202 which permits the actuaries and accountants to accept the other's opinion, section 3205 simplifying the annual report and its distribution, and section 3208 on the simplification of notice to interested parties will significantly ease the burden of compliance with ERISA.

As a small employer, we have been subjected to significant actuarial and accounting costs to comply with the detailed reporting which has not proved useful to our employees. While we are completely in accord with the objective of informing an interested participant both as to the status of the plan and the amount of his vested benefit, we believe the proposed concept of an employer responding to a specific inquiry rather than a required blanket distribution of information is by far the better approach.

With regard to subtitle C, section 3301 permitting participation on a plan-year basis and allowing a single entry date each year will greatly reduce the administration of bringing in new entrants without any detriment to the employee. Clarifying the requirement of notice when vesting schedules are changed and permitting a change in actuarial assumptions without amending the plan is only commonsense.

Since the application of actuarial assumptions to determine optional benefit forms represents a relationship, and since this relationship does not vary materially even with substantial changes in actuarial assumptions, there is no potential loss to the employee on this account, and the present requirements represent unnecessary bookkeeping requirements.

Finally, we specifically wish to support subtitle D, amending the funding provisions. Because our plan has a strong funded position, we intend to use the alternate funding method and can testify that the allowance to amortize past service liabilities over 30 years, if a switch back to entry age normal funding is required, will lower the threat of discontinuities in our funding program posed by this remote possibility.

We also strongly support the automatic approval of changes in funding method when such changes are not being made frequently. In this connection, we should bring to the committee's attention Revenue Procedure 81-29, which, while permitting automatic approval of some funding method changes, places an unreasonable and unnecessary limitation on the use of the alternate funding standard.

Thus, to be able to take advantage of section 412(g), the alternate funding standard, a plan must be fully funded—that is, must be able to provide for all vested and nonvested benefits earned to date—and use a method at least as conservative as the entry age normal method. This has caused us to apply for a change to the entry age normal method.

Under Revenue Procedure 81-29, they would require us not to use the alternate standard for 5 years as part of the IRS approval. This works a hardship on Chemtech, since we only learned about the alternate standard recently and have had to change our former method to entry age normal to qualify for it.

The market value of our pension assets is three times the amount required by the Pension Benefit Guaranty Corporation to guarantee benefits, and is approximately twice the value of all vested and nonvested benefits earned to date. If we are denied the right to use the alternate standard, our contribution under ERISA will be twice the amount required under generally accepted accounting principles, APB-8, and our working capital further impaired without significantly adding to the employees' security.

Since all the employees are clearly fully protected by this strong funded position, we believe consideration should be given not only to improving the alternative method by lengthening the amortization period, but also to specifying that switches to the entry age normal method for this purpose will be automatically approved in this legislation.

We have chosen to highlight these provisions of Senate bill 1541 because they would materially ease the administration of our plan without operating to the detriment of any of our employees. The remainder of the provisions of the bill do not as specifically apply to our situation, but our review of them indicates that they are appropriate in the context of a smaller employer.

Subject to the need to extend the automatic approval of a switch to the entry age normal funding method to include immediate availability of the alternate funding standard, we wish to go on record as to our support of this needed legislation.

Thank you for permitting me to appear before the committee, and I will be glad to respond to any questions you may have.

Mr. Chairman, on my right is Davis Roenisch. You mentioned Compensation & Capital in my introduction. Mr. Roenisch is our actuary with the firm of Compensation & Capital.

Senator NICKLES. Welcome, Mr. Roenisch. We appreciate your being with us today.

Before we proceed further, Mr. Harris, would you like to make some comments, and then I will ask both of you some questions?

Mr. HARRIS. Thank you.

I am Morton Harris. I am a private practicing attorney in Columbus, Ga., with the firm of Page, Scrantom, Harris, McGlamry & Chapman. I am also past chairman of a committee of the tax section of the American Bar Association. I am formally here today as president of the Small Business Council of America, which has over 1,400 small-business members in 46 States.

We also have, in addition to that, about 75 expert tax attorneys throughout the country who serve in an advisory capacity to this organization, and we are primarily interested in Federal tax and employee benefit legislation. I have been practicing in this area for approximately 20 years.

The purpose of our being here is to express full support for the intended purposes of your bill. There is no question that ERISA was very detrimental to the small plan area, and I think to put that in perspective, I would like to give some statistics that I developed 2 years ago when I spoke here in Washington at an ERISA simplification conference which was sponsored by the American Bar Tax Section.

There were at that time, and I suspect it is now approximately the same, over half a million qualified retirement plans in the country. Based on a Labor Department survey which had just been completed at that time by Price Waterhouse, it showed that approximately 70 percent of those plans had under 10 employees. It showed that 90 percent of those plans, or over 450,000 plans, had 25 participants or less.

Now, there were approximately 40 to 45 million participants in qualified plans, but only about 5 million participants are in these 90 percent of the plans. So, you can see very clearly that that is another way to look at the statistic I heard earlier this morning that less than 26 percent of all the employees of small businesses were in a qualified plan.

It is interesting to note that the small business here with 200 participants makes the small plans that I represent—and I personally represent over 100 qualified plans—really look like a very large plan.

Let me mention one or two things. I think the purpose of your bill is very, very supportive of something that has been most detrimental to an important area of our society. The reason that small business did not become actively involved in the ERISA legislation until right at the end of the line was because of the nature in which it came along. It came along in the form of four different bills—the Labor Department bill, the Senate bill, the administration bill.

There was a move right at the end, in order to eliminate owner-employees of businesses from taking advantage of their plans, to put an H.R. 10, or a Keogh limit cap of $2,500. If that had passed, it would have really meant the death knell of most of the small business plans, because without that incentive, many owners would not be as interested in putting them in as they are now.

Fortunately that effort was overwhelmingly defeated in this Senate by an amendment that was passed, 89 to 2. But small business did not get involved with the many other matters that have caused so much problem with small business. But that is not true today, and I can assure, Senator, that the ERISA legislation was primarily the reason for a group of people banding together in our organization, the Small Business Council, in order to prevent this type of thoughtlessness which comes about when you have a very comprehensive and technical bill that comes through the Congress.

It was done without much thought as to what the impact would be on administration for small business. As you know, and I am sure your records indicate, it is tremendous.

With regard to the bill, I would like to make just a few remarks. I think that as far as title I is concerned—the establishment of an Employee Benefit Administration—I think the concept of that is excellent. I think that if it comes about with the type of change in attitude that was mentioned by Congressman Erlenborn earlier this morning, it would be a great help, because as he mentioned—and this is very true in my own experience—the IRS is interested in compliance and in collecting revenue and in imposing penalties.

The Labor Department is very zealous in protecting the participant, notwithstanding what it might do to the "engine," (i.e. the plan sponsor) that supports the plan and even though it may be detrimental to the employer. Between the two departments, there has been a great deal of problem.

So, we do support this concept. However, as far as any official position of the Small Business Council is concerned, we have not taken such because of the fact that obviously, as was mentioned, this could very well mean another layer of bureaucracy that could very well be more harmful than what is presently there.

It was mentioned that it will create less bureaucracy. If that be the case, I think we would support that.

With regard to your title II, "Employee Deductible Contributions," our organization was in the forefront of that effort to improve the deductible limits on employee deductible contributions and to extend that benefit to the 45 million people now covered by qualified plans. We testified before the Senate Finance Committee in February and submitted a statement, and I would hope, with your permission, we would be able to submit that additionally as part of the record in support of that aspect of your title II.

I think that to extend the legislation to cover mandatory contributions would be something that we had supported and we had encouraged. We also encouraged the higher limit of $5,000 per year because if you figure out the kind of money that is being put into those deductible contributions, although it is $500 more than permitted before, we are looking at a level that would be less than the total combined social security tax that is imposed on the owner and employee, who are both sides of that equation, which costs a little over $4,000 today and is going up in 1982, as you know.

So, what we are allowing as a $2,000 deductible contribution is somewhat less in 1982 and will be a lot less in several years than what is being required to be put in for social security. So, I think the limit, although it was encouraging to see it go up, did not go up far enough, I think, to do the kind of job—to encourage savings—that I know the legislation was intended to do.

With regard to title III and the various changes, I want to mention two. The summary annual report which was just mentioned is something that is totally incomprehensible to most of the employees of my clients. They are not interested in that. They look for their own certificate, as has been mentioned earlier. They are not interested in the financial situation of the trust fund.

I do think that to require the information making available upon request, although it sounds like it might simplify the disclosed requirement, is not going to eliminate any of the paperwork because if it has to be prepared in case someone asks for it, it is no big deal to run off 10 xerox copies for most of these plans and give them to someone, whether they read them or not. I think it would be better to eliminate the summary annual report in it's entirety, and if somebody wants to take a look at the annual report which is required, and, of course, their own certificate, they can do so; that is already prepared. But to have a summary annual report that is even available is not going to eliminate any paperwork, in my opinion.

With regard to the notice to interested parties, that is almost ludicrous, at the time that these corporations adopt plans. You have prepared this long statement as to when employees have a right to go report, complain, or what have you, and you spend a lot of time preparing that. This is one of the reasons why the cost of instituting plans has gone up; just the amount of time that has to go into getting a plan qualified is significantly more involved than it was pre-ERISA.

This is one of the things—in my knowledge of the literally thousands of employees that I am familiar with, nobody has ever been interested in going to Washington to testify about the plan, which is an extra benefit and not a smaller one. I think that the notice to interested parties should be just totally eliminated, at least in the smaller plans. It may be that it had a purpose in big plans, for some employee organization that was interested and wanted to determine whether they were getting what they thought they were getting. But I think in the smaller plans, it is absolutely a waste of time and just adds to cost.

With regard to title IV, 4/40 vesting, our organization spent considerable time this year, and recently honored Congressman Erlenborn and Senator Matsunaga for their special efforts in trying to prevent the Treasury from imposing their own views contrary to congressional intent. We applaud the codification of 4/40 vesting in the code. I think it is very much needed in order to give some safe harbor to small plans.

There is one area that is not mentioned in your bill that I think is equally as horrible as far as smaller plans are concerned, and that is section 414(m) and sections 414(b) and (c). Now, what that involves, Senator, is the aggregation of related companies--this applies mostly to small plans—so that they will have a single kind of a plan.

There is no question that there may have been some abuses out in the private sector by some employers trying to exclude certain employees from coverage. But by and large, the kind of legislation that has been passed has been termed as the "congressional atomic flyswatter." Section 414 did take care of the problem, but it also eliminated some plans, and I will give you one real example of a client of mine.

A company that makes industrial wiping towels as a fabricator bought a cotton mill in south Georgia to solidify its source of supply, because there were some problems several years ago, as you may recall, in getting cotton at any kind of decent price, and in milling it.

When they bought this mill, they had about 300 employees in this small Georgia town; they bought it as a wholly owned subsidiary. The parent company had about 100 employees, and the situation after the mill was bought in south Georgia was that they were related under sections 414 (b) and (c). There was no way to come out and prevent that section from applying.

The cost of covering these additional people was impossible. The net effect was that we terminated the parent company's plan. So, here are 100 people who are not covered today who would have been covered, absent the provision. I think section 414 needs to be completely redone. I realize it is not part of your bill, but I think it needs to be taken up as a very serious part of the problem that exists in small plans.

Now, finally, with regard to title V—and that, of course, has to do with the retirement payroll deduction plan—I think that that in and of itself is a good idea. The fact that it is being mandated, I think, will create some problems because small business will look at that merely as another overlay of something they have to do.

I do think, however, that there is an analogy that can be drawn upon from the sales tax approach in many States, and that which would be helpful; is people who are required to collect sales taxes are often given some small rebate in order to cover their incremental costs in doing so.

I think there would not be a revenue impact involved because I do not see the costs as great, but I do think that an incentive ought to be given in order to require a payroll deduction plan. I do think that the proposal will work; there is no question that payroll deduction requirements do result in everybody participating in whatever it is they are deducting for in a much larger way.

At the same time, I think your proposal will impose additional cost on small business—I think companies ought to be compensated in some small way if they are required to set up such plans.

In conclusion, I would just like to say that we are very appreciative in our organization of what you are doing to bring forward a problem that has been going on now for almost three-quarters of a decade. There is no question that there is a great deal that needs to be done, and I think your comprehensive approach to it is the only way that it is going to be resolved.

I would like, with your permission, sir, to enter into the record a statement that I gave here in Washington 2 years ago on what ERISA did to small business, because it contains a number of statistics, a number of special examples, and also a list of resource materials that I am sure would be of some interest as far as the small-business aspect is concerned.

Thank you.

[The prepared statements of Mr. Harris and the Small Business Council of America, Inc., follows:]

STATEMENT OF
MORTON A. HARRIS, ESQUIRE, PRESIDENT
SMALL BUSINESS COUNCIL OF AMERICA, INC.
AT HEARINGS ON S. 1541 BEFORE THE SUBCOMMITTEE ON LABOR
OF THE COMMITTEE ON LABOR AND HUMAN RESOURCES
UNITED STATES SENATE, WASHINGTON, D.C.
NOVEMBER 4, 1981

Good Morning Mr. Chairman and Members of the Committee:

I am Morton A. Harris of the law firm of Page, Scrantom, Harris, McGlamry and Chapman of Columbus, Georgia. I am officially here today in my capacity as President of the Small Business Council of America, Inc. (SBCA). However, I am also appearing as an individual who has been involved in the private pension industry for over twenty years and who is vitally concerned with the continued viability and growth of a sound private pension system.

SBCA is a national organization of over 1,400 small business men and women located in over 46 states. A major thrust of SBCA's efforts, since its founding in 1979, has been to identify problems in the small employer plan area and to seek solutions through the regulatory agencies or the Congress. SBCA's constant theme has been to urge the creation of incentives - and the elimination of disincentives - for the establishment and maintenance of private employee benefit plans by small business employers.

As an initial matter, I would like to state that SBCA strongly supports the basic thrust of S. 1541 and its companion in the House, H.R 4330, introduced by Congressman John Erlenborn of Illinois. The stated purposes of this legislation - to encourage the establishment and growth of employee benefit plans and to encourage savings to meet the needs of employees and their families in the event of death, disability or retirement - are consistent with everything SBCA stands for.

Mr. Chairman, in my view, the ERISA problems of small plans and small employers resulted, in no small measure, from the fact that ERISA was drafted with little consideration given to precisely how the reporting, disclosure, and administrative burdens would fall on small plans. I really cannot fault this Committee or others involved in drafting ERISA for this deficiency. Small businesses and small plans were relatively silent when ERISA went through the legislative process. The focus of the small business legislative effort was at the eleventh hour and was devoted to insuring that small plans could retain a sufficient tax advantage to encourage their continued growth and to insuring that there was no tax discrimination against small plans. In focusing on these problems, small business interests paid insufficient attention to many, many other provisions of ERISA. I am delighted to note that since ERISA was enacted, small plans and small businesses, and indeed the entire private pension industry, have organized, and I can assure you that the small business sector will not be silent as further employee benefits legislation is considered.

Over the coming months, SBCA will be communicating with this Committee, and with the House Education and Labor Committee, with respect to details of the pending bills. For today, I would like to confine my remarks to general comments on the first five titles of S. 1541, and to identify a few items of particular interest and concern to the members of SBCA.

Title I of S. 1541 would provide for the establishment of a new Employee Benefit Administration and for the consolidation of the policy, administrative and enforcement functions of ERISA in that agency. Although SBCA has not adopted a formal position on this particular title, I would like to risk a few personal comments. On the one hand, I am very cognizant of the obvious practical and logistical problems involved in consolidating the administrative and enforcement functions of ERISA in a single agency. I am further aware of the particular political problems involved in consolidation of such functions in a new independent agency. On the other hand, there is no doubt that there is a need for adoption and implementation of a unified national policy regarding savings and provisions for retirement and for the elimination of unnecessary and duplicative administration. I think we must recognize that the existing agencies with prime employee benefits jurisdiction - the Internal Revenue Service and the Department of Labor - have fundamental missions which may not be totally compatible with the purpose of pension laws. For specific example, the function of the Internal Revenue Service is to collect taxes, and its policies inherently are developed with a primary view to impact on revenues. Employee benefit laws, on the other hand, should be administered with a primary view towards maintaining and expanding employee benefits security, not limiting revenue impact. In other words, administrative policy and discretion can and should be exercised primarily for the benefit of participants and beneficiaries, not primarily to collect taxes. I am not saying that the Commissioner does not and should not exercise proper discretion in administering the tax laws. I am saying, however, that his primary purpose is to focus on revenue impact and not on employee benefits security and this primary purpose leads to the adoption of policies which, in fact, are often contrary to furthering employee benefits security. For an example, I need point no further than the Service's continuing policy of disqualifying plans for innocent errors as opposed to seeking and encouraging remedial corrective measures. A new agency with a mission and purpose of encouraging retirement savings, and encouraging the establishment and improvement of private plans, may well be what is needed. Be that as it may, SBCA has not adopted a formal position on this matter and these are just my own views.

Title II of S. 1541 would provide for a deduction by employees and their spouses for contributions to qualified retirement plans. I am very proud of the role played by SBCA in the recent enactment, in the Economic Recovery Tax Act of 1981 (ERTA), of provisions which would provide for expanded deductions for contributions to individual retirement accounts, and, for the first time, deductions for contributions by plan participants to IRA's or to qualified plans. SBCA strongly supports this concept and we hope that it will be improved upon. For example, SBCA supports expansion of the deductibility feature to "mandatory" contributions, and, when budgetary considerations permit, we strongly support an increase in the deductible amount.

Title III of S. 1541 proposes a number of specific amendments to ERISA. As a general matter, SBCA either supports or has no objection to these changes. Many are technical changes which long have been needed. Others merely conform provisions of Title I of ERISA to comparable provisions of the Internal Revenue Code. Still others apply to special industries or situations and simply do not effect our members. There are some changes that we support, but would prefer to see amended. For example, S. 1541 would provide certain changes in connection with the Summary Annual Report. We support the changes, but would prefer the elimination of the Summary Annual Report. It appears to us that if the Annual Report itself is available to participants, then the Summary Annual Report is just added paperwork. For another example, S. 1541 would simplify some of the confusion regarding the Notice to Interested Parties. We support these changes, but again would urge elimination of the Notice to Interested Parties. We have difficulty in determining any real benefit of the Notice. It advises interested parties that a determination letter has been sought in connection with a plan. However, a plan either "qualifies" or it does not. The comments of interested parties cannot change that fact. As a result, the notice provisions appear to accomplish little more than a delay in the determination letter process.

There are two provisions of S. 1541 that we would like to single out for particular approval. One is the provision, under Section 3603, that at least one member of the Advisory Council "...shall be a representative of employers maintaining small plans." Given that small plans, under any definition, constitute well over 90% of all plans, it is only reasonable that they be represented on the Council. A second provision we strongly favor is the return to the "adequate consideration" test for determining prohibited transactions. Although much progress has been made since 1974 in granting needed exemptions and in refining the exemption process, the inherent costs and delays still preclude many small employers from entering into perfectly legitimate transactions which would be in the best interests of all concerned.

Title IV of S. 1541 proposes amendments to the Internal Revenue Code. We would like to note our particular support for Section 4810, which would provide"safe-harbors" under Code Section 411(d) relating to discrimination in vesting standards under qualified plans. SBCA has fought long and hard for vesting "safe-harbors", and would be delighted to see this matter laid to rest, once and for all, by specific legislation declaring that "4-40" vesting is a bottom-line, "safe-harbor".

There is one area presently not covered in S. 1541 which we hope will receive consideration in the final bill. This is the entire subject of employee aggregation under Internal Revenue Code Section 414(b), (c) and (m). These rules were designed, in one fashion or another, to prevent abuses in selective coverage under qualified plans. However, Sections 414(b) and (c), as interpreted by the Internal Revenue Service and the courts, go far beyond what might be termed "abusive situations", and reach situations where there is no purpose to deny coverage to low-paid groups, but merely a purpose to treat truely separate businesses separately. Code Section 414(m) was hastily drafted and is simply incomprehensible in many situations. Many very legitimate business organizations are combined or separated in one fashion or another for very legitimate business purposes. In many situations today, it is simply not possible for these organizations to determine exactly what kind of qualified plan they can have. Unfortunately, at the present time, it is our understanding that regulations under Section 414(m) are not a priority project. With the enactment of ERTA, publication of the 414(m) regulations may have been even further delayed. No one supports artificial schemes to carve out certain classes of low paid employees from coverage under qualified plans. However, it is imperative that the private sector know what the rules are and know what is permissible. For this reason, SBCA has strongly supported H.R. 3721 which would postpone the effective date of Code Section 414(m) until 90 days after final regulations have been issued by the Internal Revenue Service. SBCA is vitally interested in the adoption of clear and reasonable rules regarding the aggregation of related employers and employees. We would like to communicate further with the Committee on this subject, and with your permission, will be submitting additional specific comments on Code Sections 414(b), (c) and (m).

Title V of S. 1541 would require that employers offer individual retirement payroll deduction plans for employees not covered by qualified plans. While we appreciate the Committee's desire to encourage employers to extend administratively simple options to employees to encourage their individual savings for retirement, we are concerned that a mandatory IRA program could be quite burdensome for small employers. We would hope that the mandatory nature of Title V would not be imposed until more experience has been gained under the new voluntary incentives enacted in ERTA. Our own view is that with sufficient tax incentives, individuals will participate in IRAs offered directly through banks, thrifts, insurance companies, and other financial institutions. In this regard, we would sincerely hope that the financial institutions will actively step up their solicitation of individuals for participation in IRAs, and will develop voluntary payroll deduction programs which would be attractive to small employers. In a nutshell, we support the concept of Title V, but have concerns over the mandatory feature.

Mr. Chairman, the SBCA is delighted that this Committee and the Congress are commencing a careful and reasoned review of ERISA with a view towards the adoption of specific legislative relief. As you know, Congressional efforts to date have largely been to encourage or to force the agencies to take or to refrain from taking certain administrative actions. Although there remains much that could be done administratively to improve ERISA, we believe the time has come for legislative action. We encourage your efforts in this regard and we pledge our support.

Thank you.

STATEMENT OF

SMALL BUSINESS COUNCIL OF AMERICA, INC.

in support of

LEGISLATION TO PROVIDE FOR TAX DEDUCTIBLE EMPLOYEE CONTRIBUTIONS

June 1, 1981

TAX DEDUCTIBLE EMPLOYEE CONTRIBUTIONS -- BOTH A "SAVINGS MACHINE" AND A PRIVATE PENSION "RESTARTER ENGINE"

SUMMARY

Legislation providing a tax deduction for employee contributions to private pension and other qualified plans will help to achieve many of the Administration's stated goals: tax reduction -- deregulation -- increased savings -- capital formation -- relief for the Social Security system. In the process, such legislation would contribute significantly to the growth of the private pension system and the expansion of employee coverage.

All working Americans are potential beneficiaries of such legislation. In addition, the small business community will doubly benefit because a tax deduction for employee contributions will facilitate the adoption and expansion of private pension plans by small business concerns which, in turn, would significantly affect the overall expansion of pension coverage because the major area of noncoverage is in the small business community. This deduction would also help to reverse the growing trend of abandonment of private pension plans for the purpose of satisfying employees' desires to participate in qualified plan investment opportunities through the establishment of IRAs.

Another direct consequence of this incentive legislation will be expanded savings which will contribute to the expansion of investment capital and to the retirement security of working people and their families. In turn, this will reduce the need for expanded social security benefits as a means of assuring retirement security. Finally, the channeling of earnings into long-term savings funds (rather than consumption expenditure) will be noninflationary.

To achieve these benefits, it is necessary that the legislation be appropriately designed to encourage contributions of such magnitude that individuals will perceive that they can accumulate an adequate retirement fund. Thus, we urge that the legislation be simple and easy to understand, that it be uniform in its applicability, and that the allowable deduction be high enough to create an effective incentive for both low and middle income earning Americans. Specifically, we urge: (1) the deduction be allowed for all employee contributions, both voluntary and involuntary, (2) that the deduction be equally available irrespective of whether or not the employee is also covered by a company-sponsored retirement plan, and (3) that the allowance for a deductible contribution be at least $5,000.00 per year. It is essential to the realization of the desired goals that the deduction be fully available to proprietary employees so that the owners of small businesses will have both the incentive both to save individually and to institute retirement plans for their company.

Introduction

What happens to "small business" is the business of the Small Business Council of America (SBCA). The SBCA is a nationwide group of small business and professional men and women, including attorneys, accountants and other tax and employee benefit consultants, whose aim is to represent small business in the areas of federal tax and employee benefit legislation. Its primary goal is to make these laws more conducive to the good health of small business.

Background

The President's Commission on Pension Policy, in referring to the importance of savings and the status of private pension plans, states:

> Importance of Savings
>
> "Individual savings is an important component of retirement income. . . .
>
> "Aside from the importance of savings to the income of the retired, savings also play an important role in the economy because it is a source of capital."
>
> Status of Private Pension Plans
>
> ". . . the rate of pension growth has slowed significantly. . . .
>
> "The most serious problem facing our retirement system today is the lack of pension coverage among private sector workers . . ."1/

In acknowledging the "near stagnation of pension plan growth," the President's Commission propheisied that the condition would get worse as the traditionally low-pension coverage industries (trade and service) expanded faster than the rest of the economy. On this point, the Commission stated:

> "The lack of pension plan offerings in small business is a major reason why pension plan growth is expected to continue to stagnate."1/

1/ Report of President's Commission on Pension Policy, "Toward A National Retirement Income Policy" (Feb. 26, 1981), at pp. 12, 13, 26, 28, 33

The SBCA agrees with the Commission's assessment of the problems, but we do not agree with its proposed solution to mandate a Minimum Universal Pension System. There is, certainly, no need for more oppressive pension rules. Instead, there is a strong need for incentives to encourage the adoption and expansion of pension plans by small business owners; the most effective and practical way of doing this being to provide an incentive which will encourage employees to join with their employers in funding for their own retirement. A tax deduction for employee contributions - the same kind of stimulus that has proved to be a powerful incentive for employers - is the simplest and most direct way to create an offer which both employees and employers cannot refuse.

No other reasonable approach will be as effective as will a tax deduction for employee pension contributions to enhance the individual savings "leg" of the "retirement stool," and, at the same time, help to expand coverage under the private pension system. Additionally, this legislation will help to relieve pressure on the Social Security system, a recognized goal of the highest priority. This law would also help to cure the Nation's acute shortage of capital investment funds which will help in solving the need of banks and other savings institutions for greater savings.

A law providing for a tax deduction for employee contributions holds the greatest promise of any plan that has been suggested for encouraging employee savings and expanding employee retirement benefits. It is more efficient and far less complicated than the indirect stimulus provided under the present pension laws and is certainly more appealing than the Minimum Universal Pension Scheme proposed by the President's Commission on Pension Policy. In this connection, please refer to our Statement in Opposition to a Mandatory Private Pension Scheme, submitted to the President's Commission in December of 1981, an extract of which is annexed as Appendix A.

Legislation Must be Appropriately Designed to be Effective

There is growing awareness of the desirability of providing a tax deduction for employee contributions to a qualified retirement savings plans, and various bills have been introduced to accomplish this, e.g., S. 12, S. 243, S. 486, S. 1049, S. 1139, H.R. 191, H.R. 2207, H.R. 2346, H.R. 3082, and several others. Therefore, SBCA is reasonably optimistic that legislation of this kind will be adopted; however, we are very much concerned that what actually passes will not be adequately designed so as to create an effective savings incentive. For example, pending bills generally limit the maximum annual deduction from $1,000.00 to $2,500.00. Although a limit in that range will provide a modest tax deduction with some incentive, it will not allow the accumulation of an adequate retirement fund for most Americans. Thus, it cannot be expected to significantly inspire the average middle income earning American worker to try and become self-reliant in saving for his own retirement. The SBCA urges that the limits for deductible contributions be not less than $5,000.00 per year, not an excessive limit when compared with the current maximum contribution required under Social Security (a combined employee and employer contribution of 13.3% on compensation up to $29,700.00) of $3,950.00 for 1981, an amount which is scheduled to rise considerably higher within the decade.

To provide consistency and some measure of simplicity in the pattern of tax incentives for pension, profit sharing and IRA contributions, it is also urged that the deduction for employee contributions be equally available for employee contributions to either an employer-sponsored plan or to an Individual Retirement Account (IRA) or to both, and that the deduction be available for both mandatory and voluntary contributions.

Must Encourage Employees to Become Responsible for Their Own Retirement

Probably the most basic reason for providing a tax deduction for employee savings contributions is inherent in our right to the "pursuit of happiness" which we all agree includes the right to a secure retirement and the corresponding responsibility of contributing toward that retirement. Under the present tax structure and against the backdrop of inflation, there is simply no way for the average American worker to adequately save for his own retirement.

Present Tax Laws - Both Ineffective and Counterproductive

There is no longer a serious question that retirement planning, to be adequate in fulfilling the needs of our citizens, must involve a three-way partnership among Government, Employers and Employees, often referred to as the "3-legged stool" of retirement planning. Funding for two of the "legs", Social Security and employer-sponsored pensions, is largely subsidized by the tax system. We submit that it is equally, if not more, appropriate that the third "leg," private savings, receive a similar tax stimulus.

Although a deduction is presently allowed for personal savings when funneled into an IRA, the combination of the low contribution limits ($1,500.00 per year) and the inability of those covered by qualified plans to participate has caused the IRA to be largely ineffective in encouraging employee savings. In some cases, the IRA rules have actually caused the termination of qualified pension plans at the insistence of employees who prefer the control and flexibility of an IRA account. In other cases, employees have individually chosen to withdraw from participation in their employer's qualified plans in order to make themselves eligible to establish their own IRAs. Sometimes this has adversely affected the qualification of the employer's plan because the withdrawals reduce the ratio of the "non-prohibited" participants, or it has simply induced the employer to abandon the "unwanted" pension plan altogether.

Incentive for Expanding Pension Coverage

The President's Commission on Pension Policy observed that the principal deficiency of our private pension system is the large number of people not covered by it at all. Tax incentives to promote a substantial deduction for employee contributions to qualified plans would significantly encourage the retention of existing plans and the formation of new ones for the following reasons:

(1) If employees could obtain the same tax advantage by contributing to their employer's plans as they could under their own IRAs, they would likely remain in their employer's plan, thereby benefiting both from their own contributions and from their employer's.

(2) A deduction for employee contributions to either pension, profit sharing or thrift plans will encourage employers who are incapable of fully funding a meaningful retirement program for their employees to combine their contributions with those of their employees to install such programs. This would be particularly attractive to small businesses where marginal payroll costs are often the difference between staying in business or failing. If a portion of the costs of the plan can be borne by the employee, the employer will be more capable and more receptive to adopting such a plan.

(3) The availability of an employee deduction will encourage the further development of thrift plans (involving matching contributions by employer and employee) which are becoming increasingly popular with employees.

Thus, retirement plans that otherwise would never be seriously considered would come into existence, which, in turn, would lead to other plans being adopted and to the expansion of initially modest plans as the competitive forces of the job marketplace come into play. It is likely that a significant portion of this new plan activity would occur in the small business community where most of the non-coverage exists.

Relief for Social Security

A deduction for employee contributions will serve to stimulate both private savings and the private pension system, which would provide needed relief for the third "leg" of the retirement stool, Social Security. The malaise in the Social Security system, which for years has been hinted at by professionals, is now front-page news. Concerns for the solvency of the Social Security system have never been greater, particularly among young and middle aged people, many of whom seriously doubt whether the system will be able to deliver when they are ready to draw from it.

Due to the urgency of the problem, there is growing support for legislation to solve the current Social Security crisis and head off threats of its bankruptcy. At the same time, our country's savings rate is currently at its lowest ebb and the growth of private pension coverage has stagnated, thus creating growing dependency on the already over burdened Social Security leg. It is, therefore, timely and indeed urgent that we strengthen the other two "legs" which will immediately and significantly relieve the strain on Social Security. Viewed in this light, the deduction for employee contributions must become an integral component of the current proposals to protect the financial integrity of the Social Security system.

Advancing National Goals: Capital Formation, Reduction of Taxes, Inflation and Regulations

It is hard to conceive of a program more consonant with this Nation's current priorities than a tax deduction for employee contributions to qualified retirement plans. The capital formation potential is self-evident; and, with employee savings being channeled into qualified trust vehicles, it is a most efficient way to deliver funds to capital markets. Legislation of this kind will impact directly upon the economy by making funds available for business and the growth of our productive capacity. At the same time, money will be diverted from consumption to savings, thus reducing inflationary forces in the economy, which, in turn, will help preserve the value of funds accumulated for retirement.

Personal taxes will, of course, be reduced by the proposed new deduction, thus raising the fear that an increased deficit will only heat up an already overinflationed economy. It should be noted, however, that the amount of savings will always be considerably larger than the reduction in taxes, thus the deduction cannot aggravate, but will, indeed, help reduce the level of inflation. Moreover, the savings will guard the individual against the catastrophe of having to live his or her retirement years under multi-digit inflationary conditions without reserve funds. The tax deduction will both enable and encourage workers to establish their own retirement pools, free of taxes, in a form that itself is responsive to inflation.

All of this can come about with essentially no additional government regulations, provided the new legislation is not cluttered with self-defeating "anti-discrimination" rules, and not saddled with complicated reporting and other requirements.

Need for Higher Maximum Deductible Amount

It is essential that the Congress not water down the tremendous savings incentive which can result from a tax deduction for employee contributions to retirement savings. To be effective, there must not be too low a limit on the amount of the deduction, nor restrictions which permit the deduction only for voluntary contributions, nor unnecessary limitations on who is eligible to participate.

While it is appropriate that some limit be imposed on the amount of the savings deduction, it must be recognized that it is not possible for a meaningful retirement fund to be accumulated at the current $1,500.00 IRA limit which is also the average limit of the currently pending bills. The $1,500.00 limit does not reflect the severe inflation experienced since that limit was initially imposed in 1974, nor does it recognize that the accumulation potential at that rate is very limited, i.e., only $30,000.00, plus earnings, after a 20-year period. To add accumulated earnings to the fund is not appropriate since past experience indicates that earnings on savings funds will not do more than keep the "real value" of the fund from depreciating with inflation.

The early experiences under H.R. 10, when a $2,500.00 limitation was in force, make it clear that people will not rush in great numbers to establish new plans for minimal immediate benefits. The administrative costs involved in establishing the pension plans and managing the fund will often outweigh the benefits of the plan if the maximum benefit levels are too low. It could be argued that the present H.R. 10 limits, i.e., $7,500.00 or 15% of compensation, provide a reasonable precedent for setting the limit for employee deductions, since the H.R. 10 contribution is itself in the nature of a voluntary employee contribution. However, in recognition of the revenue impact of a large new tax deduction, it is suggested that a more modest limit be set at this time.

It is our recommendation that the amount of the deductible contribution be set at a fixed level of $5,000.00 per year, which is sufficient to encourage savings at meaningful levels for both lower and middle income employees, i.e., 15% of $33,333.33 per year equals $5,000.00. At this level, the deductible contribution would be: (1) large enough so that the deductible amount will adequately encourage retirement savings of a significant amount for the majority of American employees; and (2) large enough so that the administrative costs involved will not be great in relationship to the amount of the deduction. Although a logical maximum contribution limit might be directly tied to the prevailing Social Security contribution rate (presently a total of $3,950.00, based on a $29,000.00 wage base and a combined tax of 13.3%), which would bring the private incentive limit to the same level as is required under Social Security and give each "leg" of the "retirement stool" the same strength in serving the retirement needs of our Nation's employees, it is recommended that a better alternative to such a constantly moving figure would be the establishment of a related fixed figure such as $5,000.00, which would remain constant until moved by Congress. The main virtue of doing this is that the $5,000.00 limit would, in time, become generally known, and the occasions for erroneous calculations and over contributions would thus be reduced.

Deduction for Voluntary and Involuntary Contributions

The SBCA urges that the tax incentive for employee savings be provided for both voluntary and involuntary employee contributions. Although some of the legislative proposals would permit the deduction only for contributions that are not "mandatory," such a distinction would add considerable complexity to the law and would dilute the intended incentive to be created by the legislation, i.e., to encourage employee savings. First, it must be recognized that pension plans come in many designs and that in some cases, a mandated employee contribution provides the trigger for a contribution by the employer. In other cases, employees are nominally free to contribute or not, but the economic compulsion is applied in the form of a matching contribution from the employer. Presumably the rationale behind proposals to limit the deduction to voluntary contributions is that no tax incentive is needed to encourage one to make a mandated contribution. However, this rationale does not take into account the varied types of qualified plans and circumstances involved, nor does it recognize that employees will voluntarily contribute more if given the tax encouragement to do so.

To make such a distinction is not only unfair to the workers covered by thrift plans and contributory pension plans, but would create additional complexity in the administration of the law due to the many varieties of plans and the difficulty of determining whether or not employee contributions are "voluntary" or "mandatory." Further, it would inspire all sorts of drafting flourishes to design plans around this constraint. From the standpoint of an employee's security, and from the standpoint of the health of the economy, and, further, from the standpoint of encouraging simplicity and fairness, there should be no significance to whether the employee's contribution is voluntary or mandatory.

Small Businessmen Need an Irresistible Incentive

Too often Congress has succeeded in incensing (rather than creating an incentive) small businessmen. ERISA is a classic example. Congress, by providing a tax deduction for employee contributions to qualified plans, now has an opportunity to create an irresistible incentive for small businessmen to do something for their employees by doing something for themselves. To accomplish this, it is necessary that proprietary employees be given the same savings opportunities, proportionate to their salaries (and subject to appropriate limits), that are given to all other employees.

Experience has shown that the surest way to inspire a small company to institute a benefit advantageous to its rank-and-file employees is to give its proprietary employees a meaningful incentive to participate in the benefit. Of course, it is entirely appropriate to require that benefits available to proprietary employees also be available to the rank-and-file; but to deny to these employees what would be available to the rank-and-file is, in most cases, to deny the benefit to everyone. Although 90% of the approximately 500,000 qualified pension plans in the country are sponsored by small businesses, the greatest pockets of noncoverage under qualified plans is in the small business community, which suggests that the number of qualified plans would be vastly higher if small business owners are given additional incentives to create new and to expand existing company-sponsored plans.

Conclusion

Congress should act now in taking the opportunity to follow a path that other nations have already seen the wisdom of pursuing. By providing a tax deduction of an adequate amount for employee contributions to qualified retirement plans, employees will be helped to help themselves and the Nation. This kind of incentive, if appropriately structured, can be the "engine" which will restart the expansion of pension plans and rebuild the Nation's fund of private savings.

Small Business Council of America, Inc.

By Morton A. Harris
President

By Alvin D. Lurie
Special Counsel

APPENDIX A

Extract from "Statement in Opposition to a Mandatory Private Pension Scheme," submitted to the President's Commission by Small Business Council of America, Inc. on December 12, 1980

> "Not only would many workers have to be laid off my small business, but many small businesses would die under the compulsion of added payroll costs. Small businesses, which employ more than half of the American work force, are both far more marginal and far more cyclical than large corporations. They are, therefore, subject to greater economic pressures. An increase in the marginal cost of each employee may not affect an employer of ten thousand workers at all, but will have a very major effect on an employer of ten workers. In response to competitive pressures, an increase in the cost of labor must inevitably decrease its use. Therefore, the requirement that small businesses provide pension benefits to their employees, which increases the cost of employing each worker, must decrease employment opportunities in the economic sector in which most jobs are created. Unemployment will inevitably rise, as marginal workers, the young and minority group members, are laid off more rapidly, and hired more slowly.
>
> "The experience will be much different than that which followed enactment of ERISA. ERISA's passage left small business with several choices, all unpalatable, but choices nonetheless: one, to drop their pension plans altogether; two, to switch into less burdensome types of plans, as the massive post-ERISA switch to profit-sharing plans demonstrates; three, to drop employer-funded pension and profit-sharing plans in favor of employer-sponsored IRA and SEP programs, as growing numbers of companies appear to be doing; or, finally, to bear the pain and save their existing plans. At least under ERISA, there was a choice. A mandatory program leaves small businesses that cannot bear the pain no choice, save to go out of business (or never start the business in the first place).
>
> "Hence, a mandatory scheme which has as its immediate goal the expansion of retirement plan coverage can, in fact, swiftly contribute directly to the contraction of coverage; for with no employer to sponsor the retirement plan, there is no plan, and, indeed, no job."

(Note: In the interest of economy, excerpts from the Ali-Aba Course Material Journal, Vol. 3 No. 6, were retained in the files of the committee.)

Senator **Nickles**. We will be happy to enter that into the record. Are you finished with your statement?

Mr. **Harris**. Yes.

Senator **Nickles**. Thank you very much, Mr. Harris. We appreciate your comments, as well as Mr. James'.

Senator, do you have a comment?

Senator **Williams**. I am curious about that statistical material you just mentioned concerning the growth or the demise of plans in the small business community. What period of time does it cover?

Mr. **Harris**. The statistical material I have, Senator, is merely a picture at a particular time—approximately, 1979. This was a report made for the Labor Department by Price Waterhouse, and it just showed the number—among other things, it showed the cost impact on small business, and it also showed the number of small business plans and, approximately, their sizes out of the overall spectrum of plans, to show that 90 percent of all plans had under 25 participants.

The law was designed not with those people in mind, and I think that is what gave rise to much of the problem. It does not have the information that you just mentioned as to what happened afterwards. I do know from the standpoint of my own experience—let me make this one small comment. In preparing that statement in 1979, I surveyed various members of my committee; I was chairman of a tax section committee of the ABA at that time.

It involved, and I made this statement, approximately 7,000 qualified plans, all of which were small. Many of these same people are members of our legal advisory board of the Small Business Council. There is no question that the kind of cost impact that ERISA made administrativewise on a per participant basis was, like, 50 to 1 compared to a plan that would cover 1,000 employees, because as was also mentioned, you have got to do the same thing whether you have seven employees or whether you have got 2,007.

Senator **Williams**. Thank you, Mr. Chairman.

Senator **Nickles**. Thank you.

A couple of questions. Mr. Harris, I will ask you first. We have talked about costs, and you mentioned that you represent and work with a lot of firms, I guess, in setting up their plans and administering their plans.

Mr. **Harris**. Yes, sir. I am an attorney and I represent approximately 100 different qualified retirement plans—pension and profit-sharing plans.

Senator **Nickles**. If a medium-sized employer, let us say, with 50 people came up and said, "Mr. Harris, I would like to start a defined benefit plan; I do not know that much about it, but I would like to have it pay 30 percent of their salary at retirement age 65, but I do not know very much about that; could you explain that for me and give me an idea of what it costs to get it set up and what it would cost on an annual basis to run it," could you give us any of those figures?

Mr. **Harris**. I can give you that. In fact, I do some speaking for Ali-Aba and P.L.I at seminars, and that is one thing that I have mentioned.

The cost of setting up a defined benefit plan in our area, whether it be 50 employees or 12, will run approximately $3,000 in legal fees; the actuarial cost depends. I will not try to quote my friend's fees.

Senator **Nickles**. The legal fees are $3,000, and it has an actuarial cost. Would you care to describe this, and keep in mind that we are talking about on a national basis also.

Mr. **Roenisch**. Yes, sir, and it is quite correct to note that there is a cost below which you cannot go. I would estimate it would be $2,000 to $2,500, at a minimum, for actuarial costs.

Senator **Nickles**. For setting up a plan?

Mr. **Roenisch**. Yes, sir.

Senator **Nickles**. For setting up, you are talking about legal fees of $3,000, and another $2,000 or $3,000 in actuarial cost. You are talking about $5,000 and maybe $6,000 as far as setting up a defined benefit plan for a small employer, regardless if the size, is 10 or 100.

Mr. **Harris**. That is approximately correct.

Senator **Nickles**. That is interesting information.

Mr. **Harris**. The ongoing costs, sir, to answer the second part of your question, run considerably higher in a defined benefit plan because you need constant actuarial evaluation. As far as the legal fees are concerned, they are somewhat higher, but not much.

I would hate to venture a guess with regard to a larger sized company, as you mentioned, but I do know that in the smaller firms, that fee will run in the neighborhood of approximately $1,000 a year in order to make the actuarial evaluation.

Senator **Nickles**. If you are talking about a small firm of 20 or 25 employees, what would the actuarial cost be annually.

Mr. **Roenisch**. $750 to $1,000; yes, sir.

Senator **Nickles**. What is the annual expense for a larger business?

Mr. **Roenisch**. It would run $2,000 or $3,000, I would think.

Senator **Nickles**. On an annual basis?

Mr. **Roenisch**. Yes.

Senator **Nickles**. Now, I will follow that up. Do you think that with the changes we have made under this piece of legislation, we will be reducing that cost to small employers as far as, one, initiating their plan, and, two, in operating their plan? I am talking about the legal expenses and the actuarial annual expenses of continuing the plan.

Mr. **Harris**. I can see that there is considerable simplification in this bill, and I can see that it will simplify plan administration somewhat. I think it will somewhat reduce the initial cost. I can see that it would reduce the ongoing costs significantly.

You did not mention something I know you have been interested in all today, and that is the comparison with defined contribution plans. Generally, those costs of setting up may run $1,500 to $1,700, with very little maintenance costs, except for ERISA problems.

Just one real example of needless complexity in ERISA that is most prevalent: there is a lack of symmetry between the dates applicable to when you get into a plan when a participant receives an allocation, and how vesting is measured. You measure eligibility from the date of employment. You then measure the allocation on a plan year. When you terminate employment and start figuring out vesting, you may have to pick up a year that would cover a part of a year when the participant was not even a member of the plan because he may have had 1,000 hours of several during that "plan year."

The problem of termination, is the ongoing problem of the office manager or whoever is handling it "in-house" who is often not capable of handling what may appear to be a fairly routine detail to a benefit consultant. It is getting better now after 5 years; some official personnel are getting used to it. But you are talking about 20 to 25 percent of every vesting determination by the administrative committee of the plan being incorrectly done under the rule of ERISA because there is a lack of symmetry in all of these different determinations which used to be, pre-ERISA, all on a participation basis or a plan year.

I think the ERISA change was just a small thing which has not benefited anybody much. Maybe 6 months earlier, they get into the plan; also, maybe they get an extra year of vesting at the end. But it has not been significant enough to warrant the kind of chaos that has been created for people who really cannot afford to keep their plan going by having to call their attorney or their plan consultant everytime somebody terminates so they can figure out the proper vesting.

Senator **Nickles**. Are you saying that an employer with 30 employees possibly gets in tune with the law as it is, and then a year later somebody gets into the plan and he has to call back and say:

> Well, wait a minute; is his entry date the date he got into the plan or the date of his hire, or did he complete the 1,000 hours of service?

You call your attorney or your actuary and then they have to go through the dates, and here is the $200 bill to tell you whether or not the guy began or did not begin at that particular time, or how many years of service he actually accumulated.

Mr. **Harris**. Aside from the quantity of the fee that you mentioned, I would agree with what you said. It would not be that high.

Senator **Nickles**. Let us talk about that.

Mr. **Harris**. May I give you an example where it would be more than you just said? You mentioned $200. There have been several situations where the company has made mistakes in calculating vesting, and the next thing the company hears is the terminated employee is bringing an action against the company or making some complaint through an attorney, or just making a complaint, that they were "cheated out of their money" because they got a year short-circuited on the vesting just because of an inadvertent error. I am sure you have run into that, too.

It does cost a lot of money just to come out even and try to make everybody happy. But instead of being a great employee benefit, the plan has been the source of some antagonism because of the misunderstandings that go along with trying to figure all this out.

Senator **Nickles**. I will ask Mr. James a related question. We have talked about the cost and the need for attorneys and actuaries to comply with the law, and so on, and it is several thousand dollars. I am sure that it makes a lot of difference; probably, the smaller you are, the more of an impact that bears on your decision.

As vice president of your company, even given the cost being a minus point to some degree, is a lot of the necessary compliance—the fact that you have to fill out a form 5500 and look down on line H and see the assumed actuarial equivalent amortized over a certain number of periods—does that make you scratch your head to where that possibly causes you as much of a problem in filling out that form and the other forms as even the financial cost?

Mr. **James**. Yes. I would have liked to have commented on that, had you not asked the question. I consider that the direct cost is probably the tip of the iceberg. In our case, what happens is we end up talking to the actuary; we talk to the CPA's; we talk to our attorneys. The personnel department is involved in it, and our cost accountant or some person in our financial group is involved in it.

It is a terribly inefficient use of the time of people. We do not try to assess cost or determine our internal cost on that. If we use our CPA's time or actuary's time, or whatever, the internal time is probably much more——

Senator **Nickles**. Much, much greater than your outside——

Mr. **James**. Than the outside direct outlay type.

Senator **Nickles**. The fact that you have to have your treasurer, your accountant, or whoever to work on it.

Mr. **James**. Right.

Senator **Nickles**. And in the case of a small business—one which has 20 employees—that person is usually the manager, the owner or the operator, or his wife, or vice versa.

Mr. **Harris**. Or they try to delegate it to one of their management employees, who likewise cannot come to grips with something as specialized as this.

Senator **Nickles**. When they get their Prentice Hall "Concise Guide to ERISA" that is this thick [indicating], they do a double back flip.

Mr. **Harris**. The thing that I think typifies the whole area is the fact that you prepare a summary plan description that is "calculated to be understood by the average participant." As you know, in large groups, they give them two booklets; one that says it in as short a language as they can, but obviously no one can understand it, and the other is some sort of a cartoon book.

In small businesses, they cannot afford to give but one. But as a practical matter, as simple as you make it, if you are going to avoid the liability question of failing to say something clearly or to have important information, or in the booklet, it has to be fairly complicated. It is complicated subject matter than is impossible to state too simply. Yet, very few people can follow that summary plan description as much as I think all of us would like to believe that they do.

To think that the summary plan description is supposed to be the simplest document that comes out, to give the participant an idea of what is going on—it just goes up from there to the Prentice Hall summary, and then the services that are this big [indicating] that really tell you what is involved.

Senator **Nickles**. A couple of questions Mr. Davis.

Can you relate to us your experiences regarding the failure of actuaries and accountants to rely on each other's opinions and the difficulties that that may have caused in your company?

Mr. **James**. I can try to start on that. This is one of the points I guess I referenced, where we call the actuaries—in this case, Dave, who has been our actuary only, I guess, 2 years now. We had a not terribly pleasant experience with the last two.

But there have been numerous conversations in my office by conference telephone calls, with the accountants on one end and Dave on the other and myself on another, regarding specific applications of the plan, and more particularly, during the audit process where there have been differences of opinion and conflicts over the proper presentation of the information in our annual report and the proper presentation of information on the contribution itself—how to calculate it, what method to use, what the actuarial assumptions are, and that sort of thing.

So, again, I could not assess cost. I can only tell you from experience that it is a recurring event where we do have to try to sit everyone down in a room, generally by telephone just so we can save transportation costs, if nothing else, to come to some resolution.

As far as the substance of the issues, I would rather that Dave speak to those. But if that answers your question——

Senator **Nickles**. Well, to go a little bit further, then, Dave, do you favor this idea of requiring the accountants to rely on the actuaries?

Mr. **Roenisch**. There is absolutely no question in my mind that that is a major attractive feature of this legislation. My reason is that under the prior legislation, the accountant did not know where his responsibility ended; it was fuzzy. He could not rely on the actuarial certificate as to the liability because there was a floating liability out there. He had to check to be sure that the actuary was right, no matter how qualified the actuary was.

Consequently, by making it clear, it seems to me that the very long, extended conversations will be cut off because the accountant can certify to the employer and to the stockholders that he has relied on a professional, enrolled actuary's opinion, and that if there is anything wrong with that, that is the enrolled actuary's problem.

So, I think it is just an excellent idea.

Senator **Nickles**. Just to take one additional step, and this is not to pry into your personal requirements and what not, but to get a better idea for costs and so we will know what we are putting on small businesses, could you give us an idea of the average compensation that an actuary would charge "xyz" small employer that calls up and says, "I would like for you to do an actuarial study?" Is it not on a per hour basis?

Mr. **Roenisch**. Actuarial fees are generally on a per diem basis, in the same manner as lawyers, accountants, and others. The average experienced actuary's fee in a large metropolitan area like New York, Chicago or Los Angeles would be $150 an hour. In smaller metropolitan areas, it probably grades off to $100 to $120 an hour, but it would be unlikely that you could retain the professional services of a qualified actuary for less than that per diem.

Senator **Nickles**. Thank you.

Mr. Harris, just to finish one other thing, you basically came out in support of the single agency concept. Am I correct in that?

Mr. HARRIS. That is correct.

Senator NICKLES. On the contingency that it would not create any additional paperwork and that we are talking about additional reductions in paperwork?

Mr. HARRIS. Yes, sir, and one other comment, and that is that the single agency did have as its major purpose and thrust the type of attitude that I know it is intended to have to make the system grow and be better, which means that it has to not only better for employees, but it has got to be better for employers, also.

Senator NICKLES. Senator Williams, do you have any questions?

Senator WILLIAMS. Yes. Thank you, Mr. Chairman.

I would like to know to what extent mangers of pension funds have entered the market with a service that simplifies the plan administration procedure so that the companies do not need a separate attorney and accountant and actuary and so forth.

I thought the insurance companies were going to find this an attractive opportunity for rendering a service. What is developing in that area?

Mr. HARRIS. Well, initially, the insurance industry entered the plan administration filled just as you expected. There is a great deal of money that goes into pension plans, and this was attractive. They offered very low-cost services for setting up and handling plans, on the condition that you placed all the funds with them.

Oftentimes in smaller plans, the participants and the owners would like not to be tied into an insurance company investment. So, consequently, they were put to the choice of did they want to go with an insurance company product and eliminate some of the complications, or did they want to have the flexibility of investments and bear the cost burden?

Initially, also, Senator, there were a number of insurance companies that held themselves out in this fashion, and many of my clients, especially the smaller ones, did opt to go in that direction because it was the only economically feasible way they could initiate a plan.

Unfortunately, in the earlier years—it has improved somewhat now—but the quality of performance and compliance with ERISA has not been what it was stated to be. The company still had to deal with all of these rules, and since the insurance companies were not as expert in those areas as they preferred to be.

I think it is inappropriate for me to make any specific remarks about particular companies that just frankly did not perform the kind of service that they expressed they were able to perform. But I think it is understandable because coming with that new bill, which was the biggest change in pension laws in 40 years—not a lot of logic to it, but just a lot of rules—there just was not much expertise out there.

So, although they tried to do it the insurance industry—they were simply not capable. It certainly was an attractive marketing thing for the plan consulting firms—and, yes, they have grown tremendously. I think ERISA has been, no question, a boon to the service industries that work with these plans, and they could be lawyers or accountants or actuarial firms or plan consulting firms.

In the smaller communities where many of your small plans are, there is not the kind of expertise available in there communities from these plan consulting firms. In towns of the size of Columbus, Ga.—165,000 to 200,000 people—you are going to be relying on only the few people around in the community, and you could count them on one hand, who really work enough in the area to deal with it.

ERISA was very successful in eliminating about 75 percent of all of the practitioners in the legal field who were handling 5 or 10 qualified plans prior to ERISA. They could not economically gear up to come to grips with ERISA, so they got out of the business. So, that left just the "initiated few", plus these plan consulting groups that are coming along; some are good and some are not.

But as was mentioned, the fees of plan consultants to do the plan administration correctly are not significantly less than if others are involved. As far as the need for coordination among several professionals causing additional fees, that has added some costs because in many areas, you have to have several people involved to do the job.

I think that no matter who you have handling the administration, even the plan consultant must deal with the trustee and must deal with the committee, and somebody has got to give them that information. "Just turn everything over and we do not have to think about it anymore"; it just does not work that way, and the expense factor is not nearly as low even when you deal with these outside groups as you think it is going to be to begin with.

As the gentleman mentioned, the nonpayable costs in just your management time that is spent on trying to be sure you do not stub your toe and wind up being liable and having your plan disqualified is an incredible amount of time that I am sure occupies a lot more of your interest than it should, in your effort to try to make your business go.

Mr. ROENISCH. Senator, I would concur in that answer, but I would like to make a point.

The disclosure rules when they were published—the detail and the scope of the rules that were published by the Labor Department requiring the description of a relatively simple plan were very lengthy and burdensome.

I would like Mr. Harris to react to the concept that I think should rule here. They should require the small employer to communicate to his employees the essence of what he is trying to do—a defined benefit plan or a defined contribution plan and a short paragraph of how it works and what rights the employee has on a vested schedule.

The small employer should be allowed to almost write it up on his own, because as Mr. Harris has pointed out, the facilities are not available to him from professionals, or if they are available, they are expensive. Consequently, he should be able to describe the essence of his plan in words that his employees can understand, and file that with the regulatory authorities. And as long as that represents a reasonably good-faith compliance with the intent of having his employees know that there is a plan and the main parts of it, I think a lot of that disclosure could have been and could be accomplished by the employer himself. For 25 people, he could sit down and write on a single piece of paper what he is trying to do.

What happened is everybody got frightened because the disclosure rules were very voluminous. They emphasized the negatives as to when you lose benefits and all of these things, and people were afraid to write a commonsense statement out just stating what the plan was because they thought they were going to transgress some legal requirement or suffer some penalty.

That is why I think this bill is a strong one, because the whole thrust of the bill is to say, "No; we are going to simplify this; we are going to make it easier and use commonsense."

You asked about the effect on the actuarial costs. If you keep in mind that about two-thirds of the actuarial costs are cranking out the numbers and filling out the forms and about one-third is consulting, this bill should halve the consulting costs, so that its impact on actuarial fees might be in the 10 to 20 percent range.

I think that you should also consider, particularly for small employers, very simple supporting forms. I cannot believe that the 5500-C's that the small employers file every year are ever looked at. There must be thousands of them somewhere, but I do not know who would ever look at them.

So, simplify the small employer's form that he has to report on; just have a couple of numbers, and find out whether he has got enough money to pay the benefits that have been accumulated to date—what the relationship is of the fund to vested benefits—and then let him file that every 3 years. That would, again, materially reduce the cost of his operating the plan, because a 20-, 25- or 30-employee group simply does not need the actuarial practices to run those plans very conservatively, to be sure, because the law of averages does not apply.

Consequently, even without checking, you can be pretty sure that a defined benefit plan is in a conservative position. Bob can attest to that. So, there is not the need for a detailed annual checkup for a small employer, and that would also go materially to simplify this.

Mr. HARRIS. Senator, the participant protection motives that were so prevalent in ERISA, in a small plan, really do not need to be there to the same degree as a large plan for a very good reason. The owner-employee is, him or herself, a significant participant in the small plan. Most small plans have the owner-employee as a substantial participant.

It is contrary to reason that they would do something wrong to the plan if they knew about it. So, the same reasons that went into protecting the plans against abuse and fraud, which to my knowledge are existing at the same pace today as they were pre-ERISA—the motives in small plans are not there.

If you get to a small enough plan where you have the owner who is a significant participant; that is, "wearing both hats," the kinds of things that small company plans have to do to comply with ERISA do not improve the performance of the plan.

I totally agree, not necessarily in every detail, but in essence with what was said; it makes a good deal of sense. The key thing that is so awkward to me, Senator, is that the regulations require that you must state the so called, ERISA rights in the summary plan description. They are called that—the ERISA rights—the right to sue your employer and all those things. You have got to set them out in this summary plan description.

So, you are handing your employee a summary plan description to tell him about this wonderful benefit you just put into your company, and about two or three pages at the back are spent showing how he can sue you if you do not do the right thing and stub your toe.

That, to me, is probably the most counter-productive employee relationship kind of thing I have ever seen in my life. But that is a requirement under the law.

Senator **Williams**. Is it your responsibility, or do you consider it appropriate for you to suggest to your client companies areas to look regarding for professional management of the fund?

Mr. **Harris**. Yes, sir. I have a very wide file on investment managers; I have a file on plan consultants. I deal with companies and actuarial firms throughout the country, and some beyond the oceans over in Hawaii. Some have computer capabilities and others do not.

Yes, sir, I do feel like that when I represent a client, I need to give them something to really help them and that goes beyond the technical advice that I am sure they also need to have. I came up with something to try to help coordinate all these different rules, and I noticed that in your bill you have eliminated this bonding requirement to some degree, and I think that will be helpful. When you are in a closely held situation, it is just not necessary.

But I have what I call my "who does what" letter. I send a letter out to the actuary and the trustee and the plan adviser, if there is one, with all of these reporting and disclosure rules. And I have to, of course, keep that letter up to date.

Senator **Williams**. I do not want to violate any trade secrets, but is it possible to see a copy of that?

Mr. **Harris**. Yes, sir. I published that in the American Law Institute's Course Materials Journal, and I would be happy to do that. It sets forth who is supposed to do what. I encourage everybody to sign it, so that 5 years later when you have to fill the revised summary plan description because of a material change, somebody will not say that "George" was supposed to do that.

I think the letter is helpful, but at the same time it does not reduce all of those things that we have to do. But I would be honored to present that to you because I am very proud that we came up with that.

Senator **Williams**. Thank you, Mr. Chairman.

Senator **Nickles**. Thank you, Senator Williams.

One additional question. Right now, the bill provides a waiver of the insurance premium for firms that had less than 35 people. Would either of you care to comment? Do you think that is a good provision?

The premium being what it is, I can see that it would cost more than the premium, so I can see some reason for possibly waiving it. But I also see a very good argument against waiving it, too. Would you care to comment?

Mr. **Harris**. As far as the PBGC insurance payment?

Senator **Nickles**. Yes.

Mr. HARRIS. I think that that insurance premium, if the goal of the PBGC is correct to be sure everybody gets their benefit, could be in many cases necessary. The PBGC has to be adequately funded. At the same time, in many small plans, just from my own experience, where the owner-employee is a significant participant, everything possible is done to come to that maximum contribution that you give them every year, and not the minimum.

So, the whole motive there is to put in as much as you can and get as big a deduction, of course, assuming that your company is doing well enough to have the money to put in. But in the years that it does, you tend to try and maximize the funding.

So, I do not think there is as much need in these kinds of plans where they are designed to have a healthier benefit and they are designed with the owner-employee realizing he is a significant participant to have the PBGC involved with it. But I am sure that even there, there must be some——

Senator NICKLES. Well, we did not mention excluding them from the liability, or PBGC from the liability. All that is in the bill is a waiver of the premium.

Mr. HARRIS. A waiver of the premium?

Senator NICKLES. Yes.

Mr. HARRIS. I am sorry; I did not catch that.

Senator NICKLES. And we are not really talking about the insurance provisions; I was just talking about the waiver.

Since you are representing a small business, I can see very easily where a businessman that has 15 employees is going to spend more than $33, or whatever it is, to fill out that form. I resent as an employer—I have been there—that we have actually spent a lot more than that premium was. That is infuriating to that employer but it is now a requirement to do so.

However, if you have that small employer who is covered by the insurance but not paying in on the premium—that is, the larger employers are paying in to cover their liability—that is an inequity, too, that concerns some people.

Mr. HARRIS. Right. I agree fully that the impact on small business is what you say. As to how to resolve that, whether it should be imposed on big business or just not imposed at all—my feeling is it should not be imposed at all in certain small plans.

Senator NICKLES. Do you have any thoughts on that?

Mr. HARRIS. May I make one other comment? There is already something in the bill that is along that line. For professional corporations with under 25 employees, there is no such PBGC requirement. There is a special exemption for that, and I think it was done because of the self-interest involvement that they anticipated in those kinds of organizations.

What I am saying is that whether it be a professional corporation or not, I think that the elimination of the PBGC requirement would not be inappropriate.

Mr. ROENISCH. I concur with the concept. I have some difficulty with the logic because, technically speaking, it should be the fully funded plans—the plans that have already accumulated enough assets to provide for all the benefits earned to date. Those plans are in least need for PBGC protection.

Mr. Harris said that the practice of the small employers is to be very conservative. What we are really saying is that they are much more likely to be fully funded than other larger plans, and you could bridge that over to forgiving the contribution.

It is highly unlikely that those small plans would ever cause any kind of liability to the PBGC at all. So, therefore, following that logic, changing makes sense. Where you draw the line and what happens there is a matter of judgment, but I believe the PBGC premium ought to be tied to the risk and it ought to be lower for fully funded plans as against other plans that have a funding problem.

And I might comment that under the funding requirements of ERISA itself, this problem for single employers is going to work out because the funding standard account requirements under ERISA are going to bring all employers into fully funded status.

Therefore, over time, the PBGC premium as a whole ought to be dropping for everybody. But you will notice that I carefully qualified that with "single employers"—single employer plans.

Senator NICKLES. I think we would need that qualification in some others, like the enactment of this bill, if we are going to have that happen.

Gentlemen, thank you very, very much for your input.

[The prepared statement of Mr. James follows:]

Statement of Mr. Robert L. James in support of S-1541 amending the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1954 to consolidate and simplify the administration of the law relating to retirement income arrangements.

My name is Robert L. James and I am Vice President, Finance/Treasurer of Chemtech Industries, Inc., a manufacturing corporation located in St. Louis, Missouri. Chemtech Industries has a defined benefit pension plan covering 253 active employees and 35 terminated vested and retired members. We appreciate the opportunity to testify in favor of the provisions of S-1541 and commend the efforts of Senators Nickles, Hatch and Wallop to simplify this area of the law.

More specifically, we wish to wholeheartedly endorse the provisions in Title III. For example, Section 3104 to permit the benefit payments to commence at the beginning of a calendar month, Section 3202 which requires the actuaries and accountants to accept the other's opinion, Section 3205 simplifying the annual report and its distribution, and Section 3208 on the simplification of notice to interested parties will significantly ease the burden of compliance with ERISA.

As a small employer, we have been subjected to significant actuarial and accounting costs to comply with the detailed reporting which has not proved useful to our employees. While we are completely in accord with the objective of informing an interested participant both as to the status of the plan and the amount of his vested benefit, we believe the proposed concept of an employer responding to a specific inquiry rather than a required blanket distribution of information is by far the better approach.

With regard to Subtitle C, Section 3301 permitting participation on a plan year basis and allowing a single entry date each year will greatly reduce the administration of bringing in new entrants without any detriment to the employee. Clarifying the requirement of notice when vesting schedules are changed and permitting a change in actuarial assumptions without amending the plan is only common sense. Since the application of actuarial assumptions to determine optional benefit forms represents a relationship, and since this relationship does not vary materially even with substantial changes in actuarial assumptions, there is no potential loss to the employee on this account and the present requirements represent unnecessary bookkeeping requirements.

Finally we specifically wish to support Subtitle D amending the funding provisions. Because our plan has a strong funded position, we intend to use the Alternate Funding Method and can testify that the allowance to amortize past service liabilities over 30 years, if a switchback to entry age normal funding is required, will lower the threat of discontinuities in our funding program posed by this remote possibility.

We also strongly support the automatic approval of changes in funding method when such changes are not being made frequently. In this connection, we should bring the Committee's attention to Revenue Procedure 81-29 which, while permitting automatic approval of some funding method changes, places an unreasonable and unnecessary limitation on the use of the Alternate Funding Standard. Thus, to be able to take advantage of Section 412(g) (the Alternate Funding Standard), a plan must be fully funded, i.e. must be able to provide for all (vested and non-vested) benefits earned to date, and use a method at least as conservative as the entry age normal method. This has caused us to apply for a change to the entry age normal method.

Under Revenue Procedure 81-29 they would require us not to use the Alternate Standard for five years as part of the IRS approval. This works a hardship on Chemtech since we only learned about the Alternate Standard recently and have had to change our former method to entry age normal to qualify for it. The market value of our pension assets is three times the amount required by the Pension Benefit Guaranty Corporation to guarantee benefits and is approximately twice the value of all (vested and non-vested) benefits earned to date. If we are denied the right to use the Alternate Standard, our contribution under ERISA will be twice the amount required under generally accepted accounting principles (APB-8) and our working capital further impaired without significantly adding to the employees' security.

Since all the employees are clearly fully protected by this strong funded position, we believe consideration should be given not only to improving the alternative method by lengthening the amortization period but also to specifying that switches to the entry age normal method for this purpose will be automatically approved in this legislation.

We have chosen to highlight these provisions of Senate Bill 1541 because they would materially ease the administration of our plan without operating to the detriment of any of our employees. The remainder of the provisions of the Bill do not as specifically apply to our situation, but our review of them indicates that they are appropriate in the context of a smaller employer. Subject to the need to extend the automatic approval of a switch to the entry age normal funding method to include immediate availability of the Alternate Funding Standard, we wish to go on record as to our support of this needed legislation. Thank you for permitting me to appear before the Committee and I will respond to any questions that you may have concerning my remarks.

Senator **Nickles**. We will be keeping the record open. As mentioned, we will have hearings next Monday. Further hearings are also scheduled on title IV of the existing bill at future times.

We would like to ask our witnesses also, to be receptive to possible questions by letter or mail that we may come up with.

Thank you very much. The meeting is adjourned.

[Whereupon, at 12:07 p.m., the subcommittee was adjourned.]

RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE SIMPLIFICATION ACT OF 1981

MONDAY, NOVEMBER 9, 1981

U.S. SENATE,
SUBCOMMITTEE ON LABOR,
COMMITTEE ON LABOR AND HUMAN RESOURCES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:45 a.m., in room 4232, Dirksen Senate Office Building, Senator Don Nickles, (chairman of the subcommittee) presiding.

Present: Senator Nickles.

Senator NICKLES. Good morning. I would like to welcome you to the second day of our ERISA hearings on S. 1541, the bill which would remand the Employee Retirement Income Security Act, the so-called ERISA.

Today is the second day devoted to the first five titles of the act. On Thursday, we will be taking up the fiduciary responsibility, the prohibited transactions—excuse me. On Thursday, we will be taking up title VI of the bill, the insurance provisions relating to single employer. In February, we plan to take up hearings on S. 1748, which deals with multiemployer termination. On January 26, we will be taking up the prohibited transactions, fiduciary responsibility.

Today, we have a full schedule before us. I am looking forward to hearing testimony from several people and receiving their comments and expertise on what is good or what can be improved on S. 1541.

On our first panel this morning, we have Charles Moran, who is senior vice president of Manufacturers Hanover Trust, New York and Richard Loeber, who is vice president of Aetna from Hartford, Conn., representing the American Council of Life Insurance; we also have Ted Groom from Washington, D.C., representing a consortium of insurance groups and also the Western Conference of Teamsters.

Charles, good morning. Would you care to start? We have a big panel today. If all of our guests would be so kind as to highlight their statements, the entire statements will be incorporated in the record. I have read all the statements of the witnesses today, so I should be somewhat familiar with them, and we should be able to move fairly quickly.

Thank you.

Please go ahead.

STATEMENT OF CHARLES A. MORAN, SENIOR VICE PRESIDENT, MANUFACTURERS HANOVER TRUST CO., AND CHAIRMAN OF THE BOARD AND PRESIDENT OF LIONEL P. EDIE & COMPANY, INC., AND CHAIRMAN OF THE EMPLOYEE BENEFIT SERVICES COMMITTEE OF THE TRUST DIVISION OF THE AMERICAN BANKERS ASSOCIATION; RICHARD H. LOEBER, VICE PRESIDENT, GROUP DIVISION, AETNA LIFE & CASUALTY, HARTFORD, CONN., REPRESENTING AMERICAN COUNCIL OF LIFE INSURANCE; AND THEODORE R. GROOM, ESQ., WASHINGTON, D.C., REPRESENTING A CONSORTIUM OF INSURANCE GROUPS AND THE WESTERN CONFERENCE OF TEAMSTERS PENSION TRUST FUND, ACCOMPANIED BY GARY FORD, ESQ., A PANEL

Mr. MORAN. Thank you. I am here today representing the Trust Division of the American Bankers Association.

We applaud the introduction of S. 1541 and appreciate the opportunity to appear at this hearing to review both ERISA and this particular bill.

From the perspective of 1981 and really to some extent, in reaction to the 1970's, there is a need for action to encourage the growth of the private retirement system. Congress has recognized the need to expand the private retirement system and has taken two important steps toward that end by expanding the eligibility for IRA's and increasing the deductible amounts for both IRA and Keogh plans.

A further step which can and should be taken to encourage more employers to establish plans for their employees is to eliminate from the current law the disincentives to existing plans. Most importantly, restrictions on plan investment or administration, which provide no significant measure of protection or benefit for plan participants, should be eliminated from the current law and carefully avoided in the future. We would urge the subcommittee to be particularly wary of proposals advancing investment goals other than for providing retirement income benefits.

We urge repeal of the prohibited transaction provisions. We understand that this issue is to be the subject of a later hearing. It is most important that these unduly restrictive limitations will receive the special attention of the subcommittee at that time. We feel these inflexible provisions impose excessive, costly burdens which have resulted in lost investment opportunities, without providing any additional protection to plan beneficiaries. Repeal of those prohibited transaction provisions would be a significant step forward.

As professional fiduciaries, we endeavor to provide employee benefit plans with high quality service in the most effective manner. Bank collective investment funds have offered countless smaller plans the benefits of investment diversification, brokerage, and other cost savings otherwise unavailable only to larger funds.

Unfortunately, the positions taken by the SEC have prevented the use of these funds by IRA and many Keogh plans. With the expanded eligibility and deductibility recently granted by Congress for these plans, many more individuals desirous of utilizing bank collective funds to fund their retirement savings will be denied that opportunity.

The absurdity of the SEC's position is highlighted by this new tax law. The intent of the relative provisions of the new tax law to expand coverage and increase retirement income is frustrated. The record indicates that Congress wishes that employees be afforded a broad choice of investment opportunities offered by experienced fiduciaries. In drafting ERISA, apparently in a quest for clarity, a new section was added to the Internal Revenue Code for IRA's. An apparently unintended result was to present the situation today, where depending on plan design, one employee's IRA may be invested in a bank's collective investment fund, while that employee's neighbor who wishes to establish his own IRA is denied the advantage of such a collective fund. This dichotomy does not make any sense.

Congress can make clear its intent to encourage establishment of IRA's by removing this impediment. We solicit your help, Mr. Chairman, to serve all retirement plan participants in the most efficient, appropriate, and nondiscriminatory manner. Banks need clarification of the securities laws exemptions for existing collective investment funds. In addition, granting banks mutual fund authority would provide a rational way to extend investment opportunities to nontrust accounts on a collective basis. We would urge support of this proposal, which is currently before the Senate Banking Committee.

Turning to my two final points, the reporting and disclosure requirements imposed by ERISA are far too detailed and extensive. We support the thrust of subtitle B of title III of S. 1541, to simplify compliance. However, we urge consideration of more comprehensive change in the reporting and disclosure provisions—and I do that with some trepidation, because since ERSIA became law, bank trustees and other professionals, and indeed, most employee plans themselves, have learned to cope with the reports and forms which must be prepared. In that sense, these reports have been institutionalized. To make widespread changes in substance and content of reporting now would throw many of our operations areas into turmoil.

Nevertheless, significant simplifications and savings can be realized through the elimination of certain requirements. We encourage you to permit alternative methods of reporting and to make certain reports optional, rather than changing the content or format of the specific reports. Flexibility in the statutory requirements should be accompanied by a clear congressional directive to reduce the burden of reporting. Some specifics of our frustrations are included in our written statement.

Last, the employee benefit administration. The ABA supports the establishment of a single agency to administer ERISA, and charging that agency with encouraging increased retirement savings and fostering the growth of the private pension system. A single agency, we believe, will provide efficient administration of the law, reduce cost to Government, and within the Government provide unified policy making to support the continued development of the private pension system.

The American Bankers are grateful for the opportunity to discuss our views on certain parts of S. 1541 with the subcommittee, and we look forward to the further opportunity, I guess now in January, to discuss the fiduciary responsibility provisions.

Thank you.

[The prepared statement of Mr. Moran follows:]

STATEMENT
OF THE
AMERICAN BANKERS ASSOCIATION
BEFORE THE
SUBCOMMITTEE ON LABOR
SENATE LABOR AND HUMAN RESOURCES COMMITTEE
ON THE
RETIREMENT INCOME INCENTIVES AND ADMINISTRATION SIMPLIFICATION ACT
(S.1541)

November 9, 1981

Mr. Chairman, I am Charles A. Moran, Senior Vice President, Manufacturers Hanover Trust Company and also Chairman and Chief Executive Officer of Lionel D. Edie and Company, Inc., an investment management subsidiary of the bank. Presently I serve as Chairman of the Employee Benefit Services Committee of the Trust Division of the American Bankers Association and I come before you in that capacity. ABA is a national trade association whose members consist of more than 13,100 banks, more than 90 percent of the full service banks in the United States. More than 4,000 of these institutions are authorized to serve as fiduciary and many of these presently serve employee benefit plans in one capacity or another.

We are pleased to appear before you and the members of the subcommittee to share our views on needed changes in ERISA. We congratulate you on the introduction of S. 1541 and on the prompt scheduling of the hearings to provide a comprehensive review of the law.

Mr. Chairman, ERISA was enacted to strengthen the private retirement system and to protect the interests of plan participants and their beneficiaries. The record clearly shows that in the period immediately following enactment of ERISA and as a direct result thereof many hundreds of employee benefit plans were terminated. To the extent that soundly managed plans were discontinued by their sponsors out of frustration in attempting to deal with excessive requirements in the new law and the bureaucratic increase in regulations, interpretations and delays in responding to requests for needed information, many of America's workers were deprived of an important source of retirement income. From the perspective of 1981, to some extent in reaction to the events of the 1970's -- ERISA, inflation, our nation's maturing economy and work force -- we recognize a need for encouraging the growth of the private retirement system. Social Security cannot alone meet the needs of our older population.

The Congress has recognized the need to expand the private retirement system and has taken two important steps toward that end by expanding the eligibility for Individual Retirement Accounts and increasing the deductible amounts for both IRA and Keogh plans. A further step which can, and should, be taken to encourage more employers to establish plans for their employees, is to eliminate from current law the disincentives to establishing plans. Unduly complicated regulations, needless reporting requirements, disclosures which are of no value and not read, all serve to deter the creation of new plans.

In a similar vein restrictions on plan investment or administration, which provide no significant measure of protection or benefit to plan participants should be eliminated from current law and carefully avoided in the future. We would urge the subcommittee to be particularly wary of proposals advancing "socially desirable" investment goals for employee benefit plans or directions for use of these moneys to "reindustrialize" regions in need of capital infusion or job protection. ERISA's "exclusive purpose" rule and prudence standard provide ample guidance to employee benefit plan investment managers. At the same time, adequate latitude exists within these standards to permit managers the flexibility needed to adapt to changing market conditions in a rapidly developing investment climate.

ERISA has been law for seven years now, a sufficiently long period to permit those who must work with the law, government, employers, labor and service providers, to become familiar with its technical provisions. With the benefit of this experience, we are pleased to provide you with banking's priorities for the areas most in need of change.

First and foremost, we urge repeal of the prohibited transactions provisions. We know that these provisions are to be the subject of a later hearing and we are delighted that these unduly restrictive limitations will receive the special attention of the subcommittee at that time. I just want to emphasize that we feel these inflexible provisions impose excessive costly burdens which have resulted in lost investment opportunities, without providing any additional protection to plan beneficiaries. We look forward to the opportunity to address the need for repealing these provisions at that later hearing.

As professional fiduciaries we endeavor to provide employee benefit plans with high quality service in the most effective manner. Bank collective investment funds have offered countless smaller plans the benefits of investment diversification, brokerage and other cost savings otherwise available only to larger funds. Unfortunately, the positions taken by the SEC have prevented the use of these funds by IRA and many Keogh plans. With the expanded eligibility and deductibility for these accounts, many more individuals desirous of utilizing bank collective funds to fund their retirement savings will be denied the opportunity.

Under current law the assets of corporate plans may be collectively invested regardless of the size of the company without registration under Section 3(a)(2) of the Securities Act of 1933. Congress has not, however, exempted Keogh plan collective trusts from registration under the 1933 Act. Very few banks have registered their collective trusts for Keoghs because of the burdens entailed. Instead banks have relied upon the intrastate exemption of Section 3(a)(11) of the 1933 Act. This has resulted in some strange consequences. In multistate communities such as Washington, D.C., New York and Chicago, Keogh plan trusts have to be tailored carefully so that the interest in the plan of any participant who resides out-of-state is not invested in a collective trust fund. The interest of such a person may be invested in an interest bearing deposit account. Because of the intrastate restriction, plans that are collectively invested must be policed continually to ascertain when any participant moves out of the state so the participant's interest can be withdrawn from the collective trust and reinvested in a deposit account. These nonproductive costs are borne by the plan and the bank trustee but the really unfortunate aspect is that the participant loses his ability to have his pension account invested in a diversified, professionally managed portfolio.

Many smaller banks have considered collectively investing their Keogh plan trusts and their corporate pension trusts in one fund because they do not hold sufficient assets to maintain two separate collective trusts. However, they have decided against such action because, according to the SEC, registration would be required to do this unless all corporate plans including all their participants reside in one state. The reason for this result is that the intrastate exemption requires all securities in the issue to meet the intrastate requirement.

When Congress created individual retirement accounts, it attempted to remove impediments to the collective investment of such accounts with Keogh plan assets and other 401 pension plan assets. The SEC, however, has taken the position that interests in collective trusts for IRA's are not exempt from the 1933 and 1934 Securities Acts and the trusts themselves are not exempt from the Investment Company Act. The reason for this is that the exemption provisions of these securities laws are couched in terms of trusts qualified under Section 401 of the Internal Revenue Code and IRA trusts qualify under Section 408. There is nothing in the legislative history as to why Congress utilized an entirely new section in authorizing an entirely new type account. It is sheer speculation to argue, as some do, it was to avoid the exemptive provisions of the securities laws. Nevertheless, the SEC has not allowed banks to invest IRA's collectively without registration and compliance with the 1940 Investment Company Act. As a consequence, banks do not invest IRA accounts in securities except for large rollover accounts where they can be managed economically on an individual basis.

The absurdity of the SEC's position is even further highlighted as a result of the new tax law. Under the new law voluntary contributions by employees to employer sponsored plans will be eligible for tax deductions beginning in 1982. Voluntary employee contributions to employeee trusts qualified under Section 401 of the Internal Revenue Code may be collectively invested without SEC objection and tax deductibility should not alter their status under the securities laws. It is even possible to design plans funded wholly by employee contributions to qualify under IRC Section 401, and therefore eligible for collective investment, but Section 401 imposes more extensive qualification and reporting requirements than those contained in Section 408. On the other hand, employees who wish to establish their own IRA's are denied the advantages of bank collective investment. This dichotomy makes no sense.

Congress can make clear its intent to encourage establishment of IRA's by removing this impediment. We ask that you make it clear that all IRA's may qualify under Section 401 without an increase in the simplified procedures of Section 408 which were adopted to make IRA's attractive to everyone.

ABA also supports legislation presently before the Banking Committee permitting banks to sponsor and sell mutual funds. If this authority is granted the investment management capabilities of banks will be made available to everyone. The public will greatly benefit from the availability of a wide variety of funds offered by a diverse group of investment managers.

Problems also exist under the securities laws where a smaller bank wishes to invest collectively assets it holds as trustee for personal trusts and assets it holds as trustee for pension trusts in order to provide better service to the accounts in a more economic and efficient manner. Presumably, the intrastate exemption would be available under the 1933 Act if all the accounts met the residency requirement or, maybe, even the exemptions for common trust funds and corporate pension trusts might be available. But according to the SEC such a collective trust could not find an exemption from the Investment Company Act because the pension trust exemption and the common trust fund exemption are found in different subsections of the Act and there is no intrastate exemption which might cover all the individual trusts. The common trust fund exemption alone is not available because the SEC holds that the trustee of an employee benefit trust is not a trustee.

The securities laws, as construed by the SEC, contain exemptions under which personal trusts, corporate pension trusts and Keogh pension trusts can be collectively invested so long as assets from the different types of trusts are not combined in one fund. Thus smaller banks may often find that they are precluded from using a collective trust fund not because of a lack of an exemption for each type of trust they would like to invest collectively but because it is uneconomic to establish a separate collective fund for each type of trust -- personal, corporate pension and Keogh.

In maintaining collective investment trusts banks carry the full obligations and duties of trustees subject to the fiduciary standards of ERISA and federal and state banking law and regulation. Full disclosure of these trusts is required on a continuing basis and their operation is subject to periodic examination by Federal and state bank examiners who, as stated in the Comptroller of the Currency's examination manual, have a duty to protect trust beneficiaries as well as bank depositors. Despite the lack of SEC registration and regulation, we know of no pension plan participant or sponsor who has come forward to complain to Congress or the Labor Department of injury or harm due to the failure of a bank trustee to disclose information or a bank's advertisement of trust services.

ABA has long urged elimination of this regulatory confusion. The complete removal of bank collective trusts from the regulation and reporting requirements of the 1933 and 1934 securities laws and the 1940 Investment Company Act, which we strongly recommend as the most sensible approach, will in no way jeopardize the protection of plan participants and beneficiaries.

Two other situations exist, apart from the securities laws limitations, where banks may not provide collective investment services to existing or potential employee benefit customers. Welfare plans qualified under IRC Section 501(c)(9) may not, according to the Internal Revenue Service, be collectively invested even though the size of the fund and the flow of contributions and distributions clearly indicate that collective investment is appropriate. The Service has never offered a satisfactory explanation for their position. We ask Congress to make it clear that these trusts may be collectively invested.

Present law permits public educational institutions and tax-exempt charities to provide retirement benefits for their employees through the purchase of tax sheltered annuities. In 1978 Internal Revenue Code Section 403(b) was amended to include the purchase of mutual fund shares under the tax sheltered annuity rules. We urge these organizations be offered the additional investment choice of a bank trust department's collective fund. The same restrictions on distribution should apply.

We solicit your help, Mr. Chairman. To serve our customers in the most efficient and appropriate manner, banks need the expanded securities laws exemption I have described for our existing collective investment funds, and we also need mutual fund authority in order to invest non-trust accounts on a collective basis.

Reporting and Disclosure

Mr. Chairman, as you have recognized in your proposed legislation, the reporting and disclosure requirements imposed by ERISA are far too detailed and extensive. While we support the general thrust of Subtitle B of Title III of S. 1541 to simplify compliance we would urge consideration of more comprehensive change in the reporting and disclosure provisions. ABA feels the fundamental approach in ERISA to reporting and disclosure is conceptually incorrect. The statute is too specific in spelling out how, what, when and where stated plan information must be reported. There is no need for such elaborate detail in the statute. We have favored elimination of the specifics enumerated in Sections 103 and 104 of ERISA and that the regulatory authority be augmented to require employee benefit plans to file such reports as he determines necessary to carry out the policy of ERISA. At the same time, we have urged the Congress to instruct the regulator to simplify the system and ease the reporting burden.

Since ERISA became law bank trustees and other professionals and, indeed, most large employee plans themselves, have learned to cope with the reports and forms which must be prepared. In that sense, these reports have been "institutionalized". To make widespread changes in the substance and content of reporting now would throw many of our operations areas into turmoil not seen since ERISA's reporting forms were first published. Existing costly computer programs would have to be discarded and millions of dollars would have to be spent developing new programs. In other words, we ask you to recognize, that unlike the original drafters of ERISA, you are not writing on a clean slate. Nevertheless, significant simplifications and savings can still be realized through the elimination of certain requirements. We encourage you to permit alternative methods of reporting and to make certain reports optional rather than changing the content or format of the reports. Flexibility in the statutory requirements should be accompanied by a clear Congressional directive to reduce the burden of reporting.

S. 1541 provides for an optional reporting method for master trusts. ABA has attempted for more than three years to obtain regulatory approval for such simplified method of master trust reporting. We have been informed that the Department of Labor is now very close to issuing a rule approving the master trust reporting. We would point out that Section 3203 places the reporting obligation on the trustee, as did Labor's proposed rule. Our comments pointed out, and the Department of Labor has agreed, that the Administrator should have that obligation. Only the plan administrator possesses much of the information required to be filed, and since enactment, ERISA has placed reporting with the Administrator.

Employee Benefit Administration

Mr. Chairman, ABA supports the establishment of a single agency to administer ERISA and to encourage increased retirement savings and foster the growth of the private pension system.

The frustrations experienced by bank fiduciaries with both IRS and the Department of Labor since the enactment of ERISA are far too numerous to detail here. Master trust reporting is but one example. The Labor Department has continued to demonstrate its insensitivity to reporting burdens. Exemption proceedings continue to take far too long.

A single agency, we believe, will provide efficient administration of the law, reduce costs to government, and within the government provide unified policymaking to support the continued development of the private pension system.

ABA is grateful for this opportunity to discuss our views on certain parts of S. 1541 with the subcommittee, and we look forward to the further opportunity to discuss our views on ERISA's fiduciary responsibility provisions at an early date.

Senator NICKLES. Thank you, Mr. Moran.

Next, Mr. Loeber?

Mr. LOEBER. My name is Richard Loeber, and I am a vice president in the Employee Benefits Division of the Aetna Life & Casualty Co. of Hartford, Conn. I am appearing here today on behalf of the American Council of Life Insurance and the Health Insurance Association of America. The council has a membership of 530 life insurance companies which, in the aggregate, have 97 percent of the life insurance in force in the United States and hold 99 percent of the assets of insured pension plans. The HIAA has over 300 members which, collectively, have in force over 84 percent of the health insurance written by commercial health insurance companies.

As requested, my comments this morning will summarize a couple of key points contained in a more detailed, written statement we have submitted.

We supported, and continue to support, the basic objectives of ERISA. However, we agree it is time to review the pluses and minuses of this landmark legislation and to enact new or correcting legislation where necessary. We applaud your efforts and the efforts of your subcommittee in this regard.

Our review of ERISA has led us to conclude that there are still some significant impediments to the efficient and effective operation of the private pension system. These are attributable in large degree to overregulation and to the strict application of the prohibited transaction provisions of ERISA to the long-established business practices of institutional investment managers such as life insurance companies.

We support substantially all the provisions of S. 1541, particularly those which would seek to rectify these shortcomings, including the sections dealing with reporting and disclosure, participation and vesting, and fiduciary responsibility. We are pleased that the chairman has indicated a separate hearing will be held devoted solely to the fiduciary responsibility subject.

This morning, I would like to comment specifically on two other sections of S. 1541. We strongly endorse section 3605, which would amend ERISA to preempt the many nonuniform State laws which mandate benefits that must be included or made available in group insurance policies which are used to fund employee benefit plans and State insurance laws which provide that a particular class or classes of individuals must be provided benefits. Nearly every State today has mandated benefit laws which, because of ERISA, apply only to employee benefit plans funded through insurance companies. There are two very serious problems arising out of this situation. First, by their very nature, mandated benefits are costly disruptions to collective bargaining. In most cases, they require benefits that would not have been negotiated and may, for economic reasons, require omission of other benefits that would have been preferred by the parties. In addition, these laws impose compliance costs on insurers and benefit plans because they vary significantly from State to State and are sometimes interpreted by State agencies in such a way as to pose conflict of laws problems for multistate employers. Second, because of judicial interpretations of ERISA, these costly laws apply only to insured plans. Employers who wish to avoid the expense and inconvenience of mandated benefits must adopt noninsured plans which are not protected by State regulations of any kind. Mandated benefit laws, therefore, are fundamentally flawed in these two respects. They result in State interference with collective bargaining, an area Congress wishes to protect from local intervention, and at the same time, they encourage avoidance of insurance and the protective regulation that surrounds insurance products. For these reasons, we support preemption of State mandatory benefit laws.

We also support that part of section 3605 which would preserve to the States the right to require continuation or conversion options in insurance policies issued to employee benefit plans. The insurance business believes that termination of employment should not cause a lack of access to insurance protection. In the absence of continuation and conversion privileges, some workers and their families would find themselves simultaneously without employment and without access to life and health insurance.

We believe avoidance of this difficult situation is a responsibility properly imposed on our business, and we willingly accept it.

The other area I would like to highlight concerns the clarification and improvement of the joint and survivor annuity requirements contained in section 3309 of S. 1541. The council supports the provisions of section 3309 which would allow a defined contribution plan to provide a non-annuity-type payment as the automatic benefit form, make it clear that a plan does not have to establish election procedures for an early survivor annuity when it provides a preretirement death benefit at least equal in value to the required early survivor annuity, and permit participants to elect to have the survivor annuity paid to a person other than his or her spouse.

We appreciate this opportunity to present the views of the council and the HIAA's, and I would be happy to attempt to answer any questions you may have.

[The prepared statement of Mr. Loeber follows:]

STATEMENT BY MR. RICHARD H. LOEBER ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURANCE AND THE HEALTH INSURANCE ASSOCIATION OF AMERICA ON S. 1541 BEFORE THE LABOR SUBCOMMITTEE OF THE SENATE LABOR AND HUMAN RESOURCES COMMITTEE

November 9, 1981

My name is Richard Loeber. I am Vice President, Group Division, Aetna Life and Casualty.

I am appearing here today on behalf of the American Council of Life Insurance and, insofar as my statement relates to employee welfare benefit plans, on behalf of the Health Insurance Association of America. The Council has a membership of 530 life insurance companies which, in the aggregate, have 97 percent of the life insurance in force in the United States and hold 99 percent of the assets of insured pension plans. The HIAA has 334 members which, collectively, have in force over 84 percent of the commercial accident and health insurance in the United States. Most of the members of the Council are also in the business of accident and health insurance.

We are particularly pleased, Mr. Chairman, that your Subcommittee has initiated the legislative process to implement needed revisions of ERISA by holding this hearing on your bill, S. 1541, the "Retirement Income Incentives and Administrative Simplification Act of 1981", an omnibus measure proposing extensive amendments to ERISA. Before presenting the views of our two associations on specific proposals in S. 1541, I would like to comment generally on the question of amending ERISA.

General Comments

We supported, and continue to support, the basic objectives of ERISA--that is, to strengthen the private employee benefit system so that it may better fulfill the role of providing for the retirement and other financial security of American workers and their families and to encourage the growth of this system, to cover additional employees and improve benefits under existing plans. Such growth can best be accomplished through the use of appropriate tax incentives for employers and employees at all income levels. We hope that the tax writing committees will soon consider this issue.

Although ERISA has been in place for over seven years and some of the problems that it has generated have been resolved, there still remain significant impediments to the efficient and effective operation of the private pension and welfare benefit plan system under ERISA. This undesirable situation is attributable in large degree to over-regulation, particularly in terms of additional paperwork and other administrative burdens, conflicting and burdensome state laws in certain areas, and the strict application of the prohibited transaction provisions of ERISA to the long-established business practices of institutional investment managers, such as life insurance companies. We strongly believe that it is time for Congress to deal with these problems. Thus, we urge that this Subcommittee report meaningful legislation as soon as practicable. S. 1541 clearly lays a solid foundation for such legislation.

We understand that today's hearing will cover all aspects of S. 1541, other than the proposed changes to the fiduciary responsibility provisions of ERISA (Subtitle E of Title III of the bill) and the proposed changes to the Internal Revenue Code (Title II and Subtitle B of Part 7 of Title IV of the bill). Since ERISA's enactment, the prohibited transaction provisions have been one of the most troublesome aspects of the law to our business and the plans which it serves. We welcome, therefore, the proposed changes mandated by S. 1541 relating to the fiduciary responsibility provisions, particularly those involving prohibited transactions. We are pleased that the Chairman has indicated that a separate hearing will soon be held devoted solely to this subject.

Specific Comments

I would now like to comment specifically on various provisions included in S. 1541. In some cases, I will be proposing modifications which we think should be made to particular sections of the bill.

Preemption

Our comments on the question of preemption fall into two categories: (1) comments on the problems created by state laws which mandate benefits that must be included or made available in health insurance policies used to fund employee benefit plans and (2) the relationship of ERISA to the Federal Securities laws. Our positions are set forth in detail below.

State Mandated Health Insurance Coverage--We strongly support the provisions of section 3605 of S. 1541 which would amend section 514 of ERISA to preempt (1) the many nonuniform state laws which mandate benefits that must be included or made available in health insurance policies used to fund employee benefit plans and (2) state insurance laws which provide that a particular class or classes of individuals must be provided benefits.

Background--Section 514 of ERISA attempts to set forth the basic areas of regulatory responsibility--as between the states and the federal government--respecting employee benefit plans. The Council and the HIAA believe that the provisions of this section, as particularly applied to employee welfare benefit plans and as currently interpreted by the courts, continue to permit extraordinary burdens to be placed by the states upon insured employee welfare benefit plans and further have encouraged such employee welfare benefit plans to become uninsured. We do not believe either result was intended by Congress or is in the best interest of sound regulation in this area.

More specifically, Dawson v. Whaland, 562 F2d 70, decided by the United States Court of Appeals for the First Circuit on September 1, 1977, with certiorari denied by the United States Supreme Court on April 17, 1978, holds that a state mandated insurance benefit (a New Hampshire insurance law mandating the inclusion of mental health coverage in all health insurance policies issued in that state to employee welfare benefit plans) was not preempted by ERISA. The court concluded "that ERISA does not preempt application of state law to group insurance policies when such policies are purchased by employee benefit plans." On the other hand, however, the court makes it clear that "a state may not regulate an employee benefit plan simply because the plan serves as self-insurer on all of its benefits." The net result of the decision in Dawson is to preempt state mandated benefit laws from applying to uninsured (self-insured) plans but not to preempt such laws from applying to insured plans.

Necessity for Remedial Legislation--We believe it is extremely important for Congress to clarify this situation in the interest of sound regulation of insurance and the protection of the benefits provided by employers under employee welfare benefit plans. In the first place, we support sound state regulation of insurance, yet we do not believe that a scheme where states mandate the coverages contained in health insurance policies in a nonuniform and often conflicting manner is sound state regulation of insurance. In the second place, we believe that the present effect of the ERISA preemption clause is to encourage plans to become uninsured and thereby lose the protection of important state regulatory controls.

"Mandated Coverage" Problem--The problem for insured plans when states are permitted to mandate coverages in the insurance policies can be easily discerned from an examination of the proliferation of nonuniform state laws and regulations.

Thirty-four states have passed laws relating to health insurance benefits for alcoholism treatment. Some mandate benefits for inpatient care, but not for outpatient; some require the reverse. Each law has different limitations of coverage; some require coverage only in certain treatment facilities.

Sixteen states have passed laws relating to health insurance benefits for drug addiction treatment. Some set minimum benefits, some set maximum benefits. All sixteen laws are different in their approaches to inpatient and outpatient treatment.

Twenty-seven states have passed laws relating to insurance benefits for treatment of mental illness. Some require the coverage for inpatient treatment; others require it for outpatient treatment. The outside limits required range from $500 to $10,000. Coinsurance limits range from 25 percent to 90 percent.

All fifty states and the District of Columbia have passed laws relative to coverage for newborn children. While the American Academy of Pediatrics developed a Model Newborn Childrens Act with the cooperation of the HIAA, many states saw fit to change the Model, thereby creating many substantive and compliance problems for both health insurers and multistate employer operations.

While we could continue to cite examples of nonuniform state laws and regulations affecting insured employee benefit plans, it should be clear that the situation is chaotic for insurers and their customers, the employers. Both the insurers and the employers must keep track of the types and variations of mandated coverages in each state in which they operate. These laws are constantly changing, making the mechanics of compliance increasingly burdensome.

The situation is frequently complicated by union bargaining agreements which cover employees in more than one state.

The employer ultimately is the party that bears the additional burden of costs associated with handling the abberations. These additional and unwanted costs are naturally resisted by the employer, and often it is forced to reduce desired benefits in order to keep costs reasonable or to seek to become uninsured to avoid these laws.

Furthermore, several of the states have applied their laws mandating coverage to group policies issued outside their state which cover residents of their state. The tendency for this to occur with greater frequency is most alarming. Thus, a multistate employer may negotiate or determine benefits for his employees in accordance with the laws of the state in which it is headquartered and find that such benefits are not in accordance with the law of a neighboring state where it has employees, or the neighboring state may require an additional benefit or benefits for employees in its state. This not only removes the freedom of selecting among the benefits most desired by the employer and employees but impossibly complicates the benefit structure for employers with multistate operations. Moreover, providing a benefit mandated for a few employees located in a state other than the principal state of the employer may increase costs such that the majority of the employees lose valuable coverage more widely desired by them.

In summary, the increasing number of nonuniform state laws mandating coverages in health insurance policies has made it increasingly more burdensome for insurers to provide insured coverage to employee welfare benefit plans. Moreover, these laws make it difficult and costly for the employer to provide the kind of benefits and the benefit mix most desired by the employees through an insured plan.

"Movement to Become Uninsured" Problem--As indicated, under ERISA as currently interpreted, employee welfare benefit plans utilizing health insurance are not protected from the hodgepodge of state mandated coverages, while employers which choose to be uninsured are free to provide coverages without regard to state laws. This has led many employers to become uninsured and numerous more to consider such a move. We view this as alarming both from the standpoint of placing insurers in an untenable competitive disadvantage with uninsured plans and from the standpoint of eroding the protection afforded employees by the traditional state regulatory controls that protect their coverages. While some large employers may be able to provide benefits to their employees without insurance, the experience of the uninsured multiple employer trusts indicates, for example, that other employers cannot.

In short, we do not believe Congress intended by the preemption language of ERISA to motivate employers to drop insured plans in favor of uninsured plans.

Section 3605 of S. 1541--Our associations have made it clear in previous testimony before Congress that we support state regulation of the life and health insurance business. It has proven in almost every area to be responsive to the needs of both the public and the insurance business that serves the public. We, therefore, seek to preserve that system of regulation and believe that the amendments proposed in Section 3605 are consistent with that objective.

More specifically, we believe that clause (ii)(I), which would be added to section 514(b)(2)(B) of ERISA, will resolve many of the problems created (1) by state mandated insurance benefits and the consequent movement to uninsured plans and (2) by state insurance laws which provide that a particular class or classes of individuals must be provided benefits. The addition of this clause would quite properly leave undisturbed the state's mechanism which regulates the insurance business, *i.e.*, regulation of solvency, policy forms, agents' licensing, unfair trade practices, unfair claim practices, etc. We strongly support the addition of this clause to section 514(b)(2)(B) of ERISA.

Clause (iii)(I) would preserve state laws which require that a contract or policy of insurance issued to an employee benefit plan permit an individual to convert or continue insurance coverage after he ceases to be covered under the employee benefit plan. The Council and HIAA have always been, and continue to be, strong advocates of the principle that individuals should have the right to provide for continued health insurance protection after leaving a covered group, and, therefore, we also support this provision.

Relationship of ERISA to the Federal Securities Laws--The Council supports clause (ii)(II) of proposed paragraph (c)(2) and proposed paragraph (d)(3) of section 3605. These paragraphs would establish, respectively, that under state and federal law, a participant's interest in an employee benefit plan is not a security. By so doing, these provisions would set forth in the statute the clear intent of the Congress when it originally enacted ERISA, i.e., that matters regarding employee benefit plans (with only a few specified exceptions) would be dealt with under ERISA and not under the securities laws. In codifying the original intent of Congress, these provisions are also consistent with the case law on this issue. ERISA provides a comprehensive scheme of regulation designed specifically to deal with problems regarding employee benefit plans. ERISA needs no ancillary support from federal or state securities laws which were never intended to deal with employee benefit plans and are ill-suited to such regulation.

Clarification and Improvement of Joint and Survivor Annuity Requirements

Section 3309 of S. 1541 would significantly revise the joint and survivor annuity requirements of ERISA in at least three areas with which we are concerned; i.e., (1) it would be permissible to provide a nonannuity type payment as the automatic benefit form in a plan; (2) a plan would not have to establish election procedures for an early survivor annuity, where the plan automatically provides a pre-retirement death benefit at least equal in value to the required early survivor annuity, and (3) a plan would be able to allow a participant to elect to have the survivor annuity paid to a person other than his or her spouse. We strongly support these three changes in the joint and survivor annuity provisions.

(a) Provision of Nonannuity Type Benefits as the Automatic Benefit Form--The Treasury Department regulations indicate that a defined contribution plan which offers a life annuity option, but which provides another benefit form, usually a lump-sum payment, as the automatic form of benefit payment, must (in order to conform to ERISA) be revised to make a joint and survivor annuity the automatic benefit form and the lump-sum payment an elective form. (See paragraph (a) of §1.401(a)-(11))*/ The particular fact situations involved are the thousands of profit-sharing (including thrift) plans which provided for a lump-sum payment of the participant's accumulated account value as the automatic benefit form, but which also offered the participant the option to elect to receive part or all of his account in the form of annuity payments. Under the final Treasury rules, these plans have had to be fundamentally restructured to provide an annuity as the basic benefit form or (as is more likely) drop the opportunity for a participant to elect an annuity benefit form in order to avoid making the joint and survivor annuity the automatic benefit form. Moreover, a new defined contribution plan cannot be designed to provide a lump-sum as the automatic benefit form, if it desires to provide an annuity option.

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*/We strenuously opposed this provision during the development of the regulations and again after their issuance, but were unsuccessful. In addition, this provision has been declared invalid by the Tax Court and affirmed by the Third Circuit in BBS Associates, Inc., 74 T.C. No. 83 (Aug. 26, 1980), aff'd without opinion, No. 80-2851 (3rd Cir. July 29, 1981). We have twice unsuccessfully requested the IRS to acquiesce in the BBS Associates decision and conform its regulations to the decision.

We strongly support subsection (d) of section 3309 which would clarify the law to indicate that a defined contribution plan can provide a nonannuity type payment as the automatic benefit form in the plan. We believe such a revision of the law is consistent with the original Congressional intent in enacting ERISA. If Congress had intended to mandate annuity distributions, as compared to lump-sum distributions, it would have clearly stated this in the law. But it did not. Moreover, the plans involved have been purposely designed to provide for lump-sum payments as the automatic benefit form and such a benefit form may be desirable from most participants' point of view. The annuity option is generally included as a convenience for employees who desire it. In their present form, the Treasury regulations encourage employers to drop this option which would seem clearly to run counter to the interests of plan participants.

(b) Lump-Sum Payments of Early Survivor Annuity--We also support subsection (a) of section 3309 which would make it clear that a plan does not have to establish the elaborate election procedures (either "in" or "out") for the early survivor annuity, where it provides a pre-retirement death benefit at least equal in value to the required early survivor annuity. The Treasury Department regulations presently provide that the election procedures do not have to be applied in a defined contribution plan which meets this condition; but such a provision is not extended to defined benefit plans, although there are many such plans which contain a pre-retirement death benefit which, by definition, exceeds in value the minimum early survivor annuity specified in the law. To require this type of plan to offer and explain an early survivor annuity option creates unnecessary expense and confusion.

(c) Beneficiary--Finally, we support subsection (c) of section 3309 which would permit a participant to elect to have the survivor annuity paid to a person other than his or her spouse but only if such designation is signed by both the participant and his spouse. There are various reasons, many times related to estate planning, why a plan participant may desire to have survivor payments made to a person other than the spouse. The law should not be inflexible in this regard.

We recommend, however, that the amendment drop the requirement that the designation be signed by the participant's spouse, as well as by the participant. Requiring the spouse's signature will result in additional burdens and costs for plans. Experience with the joint and survivor annuity provisions has shown that it is very difficult to get even the one signature currently required by ERISA, and requiring two signatures just adds to the problem. Moreover, under ERISA today, a plan participant can elect, without the spouse's signature, not to receive a joint and survivor annuity at retirement and elect an annuity (life annuity, period certain) that will make payments to a beneficiary other than the spouse.

Publication of the Summary Annual Report

Section 3207 of S. 1541 eliminates the ERISA requirement that each plan participant and beneficiary be furnished with a summary annual report (SAR) but requires instead that such report be posted at the principal work sites of employee participants. In addition, statements must be posted advising employees of their right to examine or receive copies of the full annual report and summary plan description and information regarding the person who can furnish them with further information about the plan.

We believe that the summary annual report should be completely eliminated. In our view, the financial information given to the participants is of such little interest and value that the additional burdens and costs involved, even in the posting of the report, are not justified.

ERISA already requires that a copy of the full annual report be made available, upon request, to plan participants and beneficiaries. Moreover, this right must be spelled out in the plan's summary plan description which each participant must receive. The availability of the financial information in this manner would seem clearly to protect the interests of plan participants. In addition, section 105 of ERISA requires plan administrators, upon request, to furnish plan participants or beneficiaries with an individual benefit statement which has the financial information they are interested in: the total benefits accrued for defined benefit plans, the account balance for defined contribution plans, and the extent to which the participant is vested or when the participant will become vested. In fact, many plans automatically provide an annual benefit statement to participants.

Thus, a participant currently has at his disposal (1) the summary plan description, (2) access to an individual benefit statement, and

(3) access to the annual report to provide him with the information he needs to determine how the plan operates, his stake in the plan and the financial activities of the plan. The summary annual report merely duplicates the information already available to the participant, and, therefore, should be eliminated.

Utilization of Age 25 and One Year of Service with a Single Entry Date for Small Plans

In order to minimize administrative work and cost, for both the employer and insurance company, plans which use individual insurance contracts as a funding media find it helpful to deal with the mechanics of the plan as of one day each year, i.e., the plan's anniversary date. However, because of ERISA's participation provisions, in order to utilize such a single entry date, many pension plans are able to establish only a six-month eligibility period, in lieu of the one-year period generally available. This results in added expense to the plan of having to temporarily cover short-term employees who will leave before qualifying for benefits. We support, therefore, section 3301 of S. 1541 which would amend section 202(a)(3)(A) of ERISA to allow plans to determine eligibility for participation on a plan year basis.

The amendment, however, provides that the method of calculating a "year of service" when a plan year is used for determining an individual's eligibility to participate in a plan is subject to regulations. We would prefer to have the rule clearly stated in the law rather than having to rely on administrative interpretations. Therefore, we recommend that section 202(a)(3)(A) of ERISA be amended to read: "For purposes of this paragraph, computation of any 12-month period shall be made with reference either to the date on which the employee's employment commenced or the first day of the first plan year thereafter."

Simplification of the Notice to Interested Parties

Section 3208 of S. 1541 simplifies the Notice to Interested Parties that must be furnished to participants when IRS approval of a plan or plan amendment is being requested. At present, the Notice must set forth a complicated series of dates (geared to the date on which the request for approval is filed) by which the participant must take action, depending on whether he comments directly to the IRS or asks the Labor Department to comment on his behalf. These dates are confusing to the employees and time-consuming to compute for a service provider that is servicing a number of plans.

We recommend that the Notice be completely eliminated since experience has shown that it has served no useful purpose even though plan sponsors have spent much time and effort in furnishing this document to plan participants. If the requirement of a Notice to Interested Parties is not eliminated, we support the simplified procedure set forth in section 3208.

Recommendations Concerning Improvement of Reporting Requirements

Section 3801 of S. 1541 would require the Secretaries of Labor and Treasury to jointly conduct a study concerning reporting forms and requirements. For 18 months from the date of enactment of the bill, while this study is being conducted, the use of the forms developed for the triennial reporting system would be suspended and small plans, during the suspension period, would be required to use the forms previously issued by the Labor Department for annual reporting purposes.

Our member companies have already reprogrammed their computers to accommodate the new Forms, and it would be a time-consuming process and involve needless additional expense for them to revise their programs again to accommodate the old Forms during the suspension period. In addition, if it is determined that triennial reporting should be reinstated, additional needless expense would be incurred again to reprogram the computers to accommodate the triennial reporting forms. We recommend that use of the triennial reporting forms not be suspended.

Special Master or Prototype Plans

Section 3802 of S. 1541 recommends that a study be conducted by the Secretaries of Labor and Treasury as to how certain institutions, such as life insurance companies, may be encouraged to develop a "special master plan" program to ease the paperwork and other burdens of adopting and operating pension plans, particularly by small employers. The core of the proposal is to shift many of the statutory responsibilities, including some or all of the fiduciary responsibilities, arising out of the plan from the employer to the sponsor of the plan, in our situation, a life insurance company.

We wholeheartedly endorse the idea of simplifying the administration of employee benefit plans. However, we believe that any "special master" program developed would be very complex and result in another layer of government regulations. Moreover, it must be recognized that shifting the responsibility to perform certain functions does not eliminate the burdens they create; it merely puts the burdens on someone else. Thus, it is extremely important that emphasis be placed on eliminating or streamlining the various requirements themselves. We also believe that tax incentives for employers to establish pension plans would be much more effective in encouraging new plan formation.

If a "special master plan" is developed, we strongly recommend that the responsibilities shifted to the sponsor be limited to reporting and disclosure and maintaining individual accounts for participants. Careful study should be given as to whether sponsors should be burdened with "fiduciary" responsibilities since it may not be either feasible or desirable for the sponsor to carry out such duties in some cases.

Amendments to the Plan Termination Insurance Provisions of ERISA Relating to Single-Employer Plans

Title VI of S. 1541 would make significant changes to the plan termination insurance provisions of ERISA as they relate to single-employer plans. The bill would change the event triggering PBGC benefit guarantees from plan termination to the liquidation or partial liquidation of the plan sponsor. Upon plan termination, an employer would be obligated to continue to fund any unfunded vested liabilities under the plan. Under current law, the employer is required to pay to the PBGC a lump-sum equal to the unfunded liability for guaranteed-vested benefits. Title VI also removes the present law 30 percent of net worth cap on an employer's liability.

We generally favor the proposed changes to the plan termination insurance provisions of ERISA contained in Title VI of S. 1541. Title VI does, however, contain several significant differences from a proposal developed by the ERISA Industry Committee (ERIC) which we support. In particular, we are concerned with proposed section 6123 which would treat the PBGC as a general creditor with regard to claims for liability to the PBGC and proposed section 6119 which would greatly broaden the concept of contingent liability following a change of contributing sponsors. We understand that ERIC will be testifying before the Subcommittee and insofar as their testimony relates to Title VI of S. 1541 we endorse their comments.

Amendments to the Internal Revenue Code

Although today's hearing does not cover the tax-related provisions of S. 1541, we would like to briefly comment for the record on several of the proposed changes to the Internal Revenue Code. We plan to deal with these issues in much greater detail when they are considered by Senator Chafee's Subcommittee on Savings, Pensions and Investment Policy.

Safe-Harbor Vesting Schedule

Section 411(d)(1) of the Internal Revenue Code provides that a plan which has adopted one of the three ERISA vesting schedules will satisfy the nondiscrimination rules set forth in section 401(a)(4) of the Code unless (1) there is a pattern of abuse under the plan (such as the firing of employees before their accrued benefits vest) which tends to discriminate in favor of employees who are officers, shareholders or highly compensated (prohibited group) or (2) there is or there is reason to believe there will be an accrual of benefits or forfeitures tending to discriminate in favor of the prohibited group.

The IRS issued very controversial proposed regulations implementing section 411(d)(1) of the Code which, among other things, proposed two safe-harbor tests (3 year/100% vesting and a graded equivalent vesting schedule) which would protect a plan against a finding of discriminatory vesting. The Council, among others, filed comments strongly objecting to the proposed regulations. Our statement argued forcefully that there was a need for a reasonable safe-harbor vesting schedule, particularly in the small plan area, and that the safe-harbor should be 4/40 vesting. In addition, our statement indicated that the two "safe-harbor" vesting schedules in the proposed regulations were far too restrictive and were clearly inconsistent with Congressional intent as reflected in the Conference Report on ERISA.

We believe that a safe-harbor to protect a plan against a finding of discriminatory vesting, except in cases where actual abuse occurs, is essential in the samll plan area in order to preserve existing plans and encourage the growth of new plans. Small employers, particularly those that adopt a master or prototype arrangement, want certainty and simplicity.

We believe that the 4/40 vesting schedule as the safe-harbor is consistent with Congressional intent as expressed in the Conference Report on ERISA and should be codified. Thus, we strongly support section 4810 of S. 1541 which would provide the 4/40 vesting formula as a safe-harbor vesting schedule.

Unrelated Debt-Financed Income--Life Insurance Contract Policy Loans

Section 4806 of S. 1541 would amend section 514(c) of the Code to provide that policy loans received by a trustee of a qualified plan do not constitute debt-financed property on which there is an acquisition indebtedness. Thus, any income derived from the investment of such funds would not be subject to the tax on unrelated business taxable income.

We strongly oppose this provision. It unfairly singles out only one type of property in a pension plan that would not be subject to the unrelated business taxable income provisions of the Internal Revenue Code and will cause a severe and immediate disintermediation problem for life insurance companies selling ordinary life insurance to qualified plans.

We have conducted an informal survey of nine companies, none of which are in the largest five companies and only three of which are in the top ten. These companies hold in excess of $2 billion of non-borrowed cash values which would be exposed to demand for policy loans by pension trustees. Obviously, substantial additional cash values held by other companies would be exposed if section 4806 is enacted.

Amendment of Integration Requirements for Plan Qualification

Section 4811 of S. 1541 provides general integration rules for defined benefit-offset plans and indicates that comparable requirements will apply to other plan formulas. Retirement, disability and survivors' benefits will be tested separately. The new integration rules would require combined Federal, State and private benefits to be at least as high in relation to compensation for lower paid employees as for higher paid employees. Social Security benefits would be taken into consideration for this purpose at 100 percent of value, including both employer financed and employee financed benefits. However, if integration is used, a combined minimum benefit of 50 percent of average pay for the highest five years would have to be provided for the lower paid employees. Also, integrated plans could place a cap on combined Federal, State and private benefits of 80 percent of pay.

We generally favor the proposed changes to the integration rules contained in section 4811. However, we believe that the 50 percent minimum benefit requirement is undesirable and should be eliminated. Such a requirement is not necessary to prevent discrimination against lower paid employees since the bill accomplishes this by requiring the combined Social Security and private pension benefits to be at least as high in relation to compensation for low-income employees as for high-income employees if the plan is to satisfy the integration rules. In any event, in most cases, retirees with low earnings who were regularly attached to the work force will receive combined benefits exceeding the specified minimum benefits.

In addition, while most integrated plans in existence would satisfy the new integration rules, a grandfather clause should be provided to sanction plans in existence when the new rules go into effect.

Improvement of Target Benefit Plan Benefit Limitations

Section 4804 of S. 1541 would subject target benefit (or assumed benefit) plans to the defined benefit plan benefit limitations of Internal Revenue Code section 415 rather than, as at present, the Code section 415 limitation on contributions for defined contribution plans. This change would permit target benefit plans to provide older employees, at the time of the plan's inception, with a benefit which takes into account past service which might not be able to be funded under the annual defined contribution limitation. Such a benefit can be provided under a target benefit plan with more predictable costs for the employer than under a defined benefit plan, since, under the former type of plan, it is the participant's account balance that determines the actual benefit to be paid. Therefore, the level of employer contributions is not subject to the plan's mortality or investment experience. Also, since the target benefit plan is not a defined benefit plan, the heavy expense of an actuarial certification can be avoided. This combination of factors would make target plans more marketable to small employers and thus contribute to the spread of pension coverage.

If this provision becomes law, however, a participant may not be able to receive his entire account balance in certain situations. This results from the fact that the IRS requires that a very conservative interest assumption be used in computing the target benefit. As a result, there may be more money available than is needed to buy the maximum benefit that may be paid to the participant. In order to avoid this problem, we recommend that a target benefit plan be given an irrevocable election at inception as to whether it will be subject to the defined benefit or defined contribution limits of section 415 of the Code.

Faster Amortization for Past Service Liabilities

Section 4808 of S. 1541 would allow employers to fund past service liabilities under pension plans with the right to deduct contributions, over a period of 5 years, rather than being limited to amortizing the liability--with appropriate deductions--no faster than over 10 years as under current law. Permitting a faster amortization schedule, with deductions, would (i) provide employers with flexibility to match contributions and deductions with profitable years and, thus, make adoption of a plan more attractive, and (ii) provide plan participants with the security of a more fully funded accrued benefit. Faster funding is a goal of ERISA and should be further encouraged.

Improving the Environment for Voluntary Pension Plans and Private Savings

Pressures for placing increased financial burdens on Social Security should be reduced by maintaining a favorable environment for the growth of voluntary pension plans and other private savings for retirement. It is widely recognized that the historic purpose of Social Security is to provide a basic floor of protection and that voluntary private pension plans and other private savings have the job of supplementing this basic floor. To the extent that such private pension plans and other private retirement savings are encouraged through appropriate tax measures, demands for costly expansion of Social Security benefits are reduced. Accordingly, we are pleased that the Economic Recovery Tax Act of 1981 increased the tax deductible limits for contributions to IRAs (Individual Retirement Accounts) and H.R. 10 plans. This Act also encourages employees covered by pension plans to set aside retirement funds by allowing them to participate in IRAs on the same basis as other individuals. It also makes a start on the desirable objective of allowing employees to deduct their own pension contributions by granting employees tax deductions, up to the IRA limits, for voluntary contributions made to pension plans.

Unfortunately, the 1981 Act does not extend comparable tax deductions for mandatory employee pension contributions. This should be remedied. The right of employees to deduct their own pension contributions should not be affected by whether their contributions are voluntary or mandatory under the terms of their plans. Extending the tax deduction to mandatory employee contributions, as well as for voluntary employee contributions, would provide more equitable tax treatment for the employees involved and would be more effective in encouraging retirement savings. It would provide more adequate financing for pension plans, making possible increased pension coverage and higher benefits. It would also increase savings and capital formation. This is especially significant in view of the fact that, in the second quarter of 1981, Americans saved only 5.3 percent of disposable income, which is significantly below the comparable savings rates in other industrial countries.

We also believe that there should be an immediate increase in the allowable tax deductible contributions to H.R. 10 plans and IRAs to correspond with the substantial increase in the cost of living.

In addition, the present dollar limits on the amount of annual pension that qualified defined benefit pension plans can provide for an employee and on the annual contributions that can be made to defined contribution plans should be removed, or at the very least, increased substantially. This would allow people to provide a retirement income commensurate with their pre-retirement standard of living.

Finally, we believe that measures which will further encourage the establishment of new private pension plans should be enacted. In our view, this means that action by smaller firms and self-employed persons must be stimulated since they involve the major elements of the work force currently not covered by private pension plans. In this regard, we urge:

(1) that an employer be allowed, in lieu of the normal deduction for contributions to a new qualified retirement plan, to take a credit against its corporate tax liability equal to its contributions multiplied by the highest marginal tax rate applicable to corporations. The credit would be available for the first five years the plan is in existence. We believe this approach targets the incentive at those corporations that are most likely to be in need of tax help in

establishing retirement plans; that is, those with earnings below the top corporate tax bracket. The proposal is designed to give these corporations the same dollar amount of tax reduction for each dollar of pension contributions as is given to corporations with greater earnings;

(2) that the rules regarding H.R. 10 plans be liberalized so that they are the same as those applicable to corporate plans in order to give the self-employed greater encouragement to establish and maintain pension programs for themselves and their employees. In this regard, a further increase in the level and amount of allowable contributions, replacement of mandatory full vesting after 3 years with a more flexible vesting schedule and removal of the other restrictions contained in the Self-Employed Individual Retirement Act would lead to an expansion of coverage for self-employed persons and their employees.

Conclusion

The Council and the HIAA appreciate having this opportunity to present our views on the important issues involved in these hearings. As indicated at the outset, we believe that the experience under ERISA to date has clearly established the need for certain corrective amendments if the law is to fulfill its necessary objectives of strengthening and extending the vital financial protections provided by employee pension and welfare benefit programs. We would be happy to furnish any additional information which the Subcommittee may find useful.

Senator NICKLES. Thank you very much, Mr. Loeber.

Our third witness is Mr. Ted Groom, representing a group of life insurance companies.

Mr. GROOM. Mr. Chairman, my name is Ted Groom. I am a member of the Washington, D.C., law firm of Groom & Nordberg, I am accompanied by Gary Ford, who is an attorney with our firm. We are testifying today on behalf of five leading life insurance companies: Prudential, Equitable, John Hancock, Connecticut General, and Aetna. These five companies provide investment and administrative services for thousands of employee benefit plans, and together manage about $75 billion in tax-qualified assets. At the outset I should note that we strongly support the testimony of the American Council of Life Insurance.

Mr. Chairman, like the other two witnesses who have just testified, our overriding concern is that the Congress approve the changes in the ERISA prohibited transaction restrictions. Thus, we are delighted that you are going to be holding hearings in January, and we hope to have the opportunity to testify at those hearings.

Today, however, we would like to urge reform in another area—ERISA's reporting and disclosure requirements. The problems in this area can best be illustrated by the document that I have in my hand. This is the ERISA annual report filed by a major industrial company. As you can see, it is an inch thick and has over 160 pages.

The annual report for larger plans requires at least 220 separate answers and items of information, plus, in many cases, lengthy attachments with complex data and calculations. Smaller plans must file a report every 3 years, with 90 to 180 items of information, and a different report in intervening years.

Yet, as you know, a recent study by the General Accounting Office found overwhelming evidence that the Government is not using much of the information in the annual report. For instance, the study found that where questions on the form were not answered by the person filing the form, the Government usually did nothing to follow up and obtain the missing information.

When all is said and done, the Government is inundated by more than a million of these annual reports each year. We believe that, because the Government requires so much detailed information, it is unable to use any of the information quickly or effectively. Thus, as we sit here today, we understand that many of the annual reports for 1979 are still stored in warehouses unused.

I would just add a personal note. We have tried to obtain annual reports in several cases from the Department of Labor, since they are supposed to be available to the public, and have been unable to do so.

ERISA's paperwork burden is perhaps most devastating for small plans and small employers. A Washington Post reporter recently found on a visit to a small midwestern city that ERISA was the most hated Federal regulatory program of all. Given ERISA's paperwork burden, it is not hard to see why.

In our view, the annual report can be reduced to a document of a few pages, about this size, and it will be a more useful document to both the Government and participants as a result.

We shall be outlining in supplemental written testimony exactly how this change can be accomplished, as well as other proposals for improvements in this and other areas. However, we would like to conclude our oral remarks by summarizing a few principles and recommendations that we think should be kept in mind in reforming this important area of ERISA regulation.

First, we recommend that the ERISA annual report be greatly abbreviated.

Second, we recommend that the summary annual report, which is now distributed to participants, be eliminated, and that the new, shorter annual report be made available to participants instead.

Third, we recommend that the information that is included in the annual report, first of all, be information that would be useful to participants, and second, be designed to alert the Government to problem areas. Where problems are indicated, the Government can examine the plan more closely.

Fourth, we believe it is essential that the Congress not make changes in any ERISA document unless those changes are very substantial. Typically, it costs more to reprogram computers, retrain employees, and set up new filing systems than is saved by small changes.

Finally, we believe that most ERISA documents should be distributed by posting them on bulletin boards at the workplace, and making them available to participants upon request. This reform would save plans huge administrative and postage costs, while resulting in distribution that is just as effective as under current law.

I would note at this point, Mr. Chairman, that our firm will also be submitting written testimony on behalf of a separate client, the labor and management trustees of the western conference of Teamsters pension trust fund. The WCT fund has spent literally millions of dollars to date in attempting to comply with the impractical rules governing distribution of ERISA documents to participants. The trustees unanimously favor many of the changes proposed in S. 1541, particularly including the provision that would allow plans to rely upon employers and local unions to distribute ERISA documents where the employer and union trustees agree to do so. This one change would save this plan about a million dollars a year.

Mr. Chairman, we appreciate this opportunity to testify on ERISA's reporting and disclosure requirements and look forward to testifying in future hearings on the prohibited transaction restrictions.

[The prepared statements of Mr. Groom follows:]

TESTIMONY OF THEODORE R. GROOM

ON BEHALF OF

THE PRUDENTIAL INSURANCE COMPANY
OF AMERICA
THE EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES
JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY
CONNECTICUT GENERAL LIFE INSURANCE COMPANY
AETNA LIFE AND CASUALTY

BEFORE THE
SUBCOMMITTEE ON LABOR
COMMITTEE ON LABOR AND HUMAN RESOURCES
UNITED STATES SENATE

NOVEMBER 9, 1981

Mr. Chairman: My name is Ted Groom. I am a member of the Washington law firm of Groom and Nordberg. I am testifying today on behalf of five leading life insurance companies -- Prudential, Equitable, John Hancock, Connecticut General and Aetna. These five companies provide investment and administrative services for thousands of employee benefit plans, and together manage about $75 billion in tax-qualified assets. The American Council of Life Insurance is also testifying on S.1541, and we strongly support the council's testimony.

Mr. Chairman, our overriding concern is that the Congress approve the changes in the ERISA prohibited transaction restrictions that are proposed in S.1541, and we hope to have the opportunity to voice our strong support for these proposals during your January hearings.

Today, however, we would like to urge reform in another area -- ERISA's reporting and disclosure requirements. The problems in this area can best be illustrated by the document that I have in my hand. This is the ERISA "Annual Report" filed by a major industrial company. As you can see, the document is close to an inch thick. It is over 160 pages long.

The Annual Report for larger plans requires at least 220 separate answers and items of information, plus, in many cases, lengthy attachments with complex data and calculations.

Smaller plans must file a report every three years with 90 - 180 items of information, and a different report in intervening years.

Yet, as you know, a recent study by the General Accounting Office found overwhelming evidence that the Government is not using much of the information in the Annual Report. For instance, the Study found that where questions on the form were not answered by the person filing the form, the Government usually did nothing to follow up and obtain the missing information.

When all is said and done, the Government is inundated by more than a million of these Annual Reports each year. We believe that, because the Government requires so much detailed information, it is unable to use any of the information quickly or effectively. Thus, as we sit here today, we understand that many of the Annual Reports for 1979 are still stored in warehouses unused.

ERISA's paperwork burden is perhaps most devastating for small plans and small employers. A Washington Post reporter recently found on a visit to a small midwestern city, Appleton, Wisconsin, that ERISA was the most hated Federal regulatory program of all. Given ERISA's paperwork burden, it's not hard to see why.

IN OUR VIEW, THE ANNUAL REPORT CAN BE REDUCED TO A DOCUMENT OF A FEW PAGES (ABOUT THIS SIZE), AND IT WILL BE A MORE USEFUL DOCUMENT TO BOTH THE GOVERNMENT AND PARTICIPANTS AS A RESULT.

WE SHALL BE OUTLINING IN SUPPLEMENTAL WRITTEN TESTIMONY EXACTLY HOW THIS CHANGE CAN BE ACCOMPLISHED, AS WELL AS OTHER PROPOSALS FOR IMPROVEMENTS IN THIS AREA. HOWEVER, WE WOULD LIKE TO CONCLUDE OUR ORAL REMARKS BY SUMMARIZING A FEW PRINCIPLES AND RECOMMENDATIONS THAT WE THINK SHOULD BE KEPT IN MIND IN REFORMING THIS IMPORTANT AREA OF ERISA REGULATION.

1. FIRST, WE RECOMMEND THAT THE ERISA ANNUAL REPORT BE GREATLY ABBREVIATED.

2. SECOND, WE RECOMMEND THAT THE SUMMARY ANNUAL REPORT, WHICH IS NOW DISTRIBUTED TO PARTICIPANTS, BE ELIMINATED, AND THAT THE NEW, SHORTER ANNUAL REPORT BE MADE AVAILABLE TO PARTICIPANTS INSTEAD.

3. THIRD, WE RECOMMEND THAT THE INFORMATION THAT IS INCLUDED IN THE ANNUAL REPORT, FIRST OF ALL, BE INFORMATION THAT WOULD BE USEFUL TO PARTICIPANTS, AND, SECOND, BE DESIGNED TO ALERT THE GOVERNMENT TO PROBLEM AREAS. WHERE PROBLEMS ARE INDICATED, THE GOVERNMENT CAN EXAMINE THE PLAN MORE CLOSELY.

4. FOURTH, WE BELIEVE IT IS ESSENTIAL THAT THE CONGRESS NOT MAKE CHANGES IN ANY ERISA DOCUMENT UNLESS THOSE CHANGES ARE SUBSTANTIAL. TYPICALLY, IT COSTS MORE TO REPROGRAM COMPUTERS, RETRAIN EMPLOYEES, AND SET UP NEW FILING SYSTEMS THAN IS SAVED BY SMALL CHANGES.

5. FINALLY, WE BELIEVE THAT MOST ERISA DOCUMENTS SHOULD BE DISTRIBUTED BY POSTING THEM ON BULLETIN BOARDS AT THE WORK PLACE, AND MAKING THEM READILY AVAILABLE TO PARTICIPANTS. THIS REFORM WOULD SAVE PLANS HUGE ADMINISTRATIVE AND POSTAGE COSTS, WHILE RESULTING IN DISTRIBUTION THAT IS JUST AS EFFECTIVE AS UNDER CURRENT LAW.

I WOULD NOTE AT THIS POINT, MR. CHAIRMAN, THAT WE SHALL ALSO BE SUBMITTING WRITTEN TESTIMONY ON BEHALF OF THE LABOR AND MANAGEMENT TRUSTEES OF THE WESTERN CONFERENCE OF TEAMSTERS PENSION TRUST FUND. THE WCT FUND HAS SPENT LITERALLY MILLIONS OF DOLLARS TO DATE IN ATTEMPTING TO COMPLY WITH THE IMPRACTICAL RULES GOVERNING DISTRIBUTION OF ERISA DOCUMENTS TO PARTICIPANTS. THE TRUSTEES UNANIMOUSLY FAVOR MANY OF THE CHANGES PROPOSED IN S.1541, INCLUDING THE PROVISION THAT WOULD ALLOW PLANS TO RELY UPON EMPLOYERS AND LOCAL UNIONS TO DISTRIBUTE THESE DOCUMENTS WHERE THE EMPLOYER AND UNION TRUSTEES AGREE TO DO SO.

MR. CHAIRMAN, WE APPRECIATE THIS OPPORTUNITY TO TESTIFY ON ERISA'S REPORTING AND DISCLOSURE REQUIREMENTS, AND LOOK FORWARD TO TESTIFYING IN FUTURE HEARINGS ON THE PROHIBITED TRANSACTION RESTRICTIONS.

WRITTEN TESTIMONY

on behalf of

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA

THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES

JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY

CONNECTICUT GENERAL LIFE INSURANCE COMPANY

AETNA LIFE & CASUALTY

on

S.1541

The Retirement Income Incentives and Administrative Simplification Act of 1981

Subcommittee on Labor

Committee on Labor and Human Resources

of the

United States Senate

Submitted by
Groom & Nordberg, Chartered
Washington, D.C.
December 3, 1981

This statement is submitted on behalf of The Prudential Insurance Company of America, The Equitable Life Assurance Society of the United States, John Hancock Mutual Life Insurance Company, Connecticut General Life Insurance Company and Aetna Life & Casualty. These five companies provide insurance and annuity contracts, pension funding arrangements, and investment management, administrative and other services for thousands of employee benefit plans throughout the United States. Together they manage more than $75 billion in tax-qualified assets.

The overriding concern of each of these companies is that Congress approve the changes in the ERISA prohibited transaction restrictions that are proposed in S.1541. We understand that there will be additional hearings on the fiduciary provisions of S.1541, and hope to have the opportunity to voice our strong support for reform of the prohibited transaction provisions at that time.

In this statement, however, we explain why we support a number of the non-fiduciary provisions of S.1541, and also urge some changes that are not proposed in S.1541. Our principal focus is on the reporting and disclosure requirements of ERISA. There are, of course, additional problems and questions under ERISA in which we are interested and, in this regard, we strongly support and endorse the testimony on S.1541 that has been submitted to this Subcommittee by the American Council of Life Insurance.

Briefly, our comments are as follows:

1. Reporting and Disclosure Requirements. We generally support the changes in ERISA reporting and disclosure requirements that are proposed in Subtitle B of Title III of S.1541. However, we urge additional reforms in this area. Specifically, we recommend that the Annual Report be greatly abbreviated, that the Summary Annual Report be eliminated (and the revised Annual Report be made available to participants instead), and that the Form PBGC-1 be eliminated and PBGC premiums filed instead with the Annual Report.

2. Joint and Survivor Annuities. We strongly support the changes proposed in section 3309 of S.1541 which would

a. exempt a plan from pre-retirement joint and survivor annuity requirements if a death benefit of equal or greater value is provided; and

b. exempt from the joint and survivor annuity requirements individual account plans that provide that a participant's vested account balance is payable in full upon the death of the participant.

3. 4/40 Vesting Safe Harbor. We strongly support section 4810 of S.1541, which would confirm and clarify the relationship between plan vesting schedules and nondiscrimination requirements of the Internal Revenue Code of 1954 (the "Code"), and generally insure that plans with so-called "4/40" vesting would qualify for tax purposes.

4. Five-year Amortization of Past Service Costs. We support section 4808 of S.1541, which would allow employers to fund past service costs over five years, rather than 10 years as permitted by current law.

5. Court Orders Relating to Alimony or Support Payments. We generally support the provision of S.1541, section 3310, that would permit in appropriate circumstances enforcement against plans of court orders relating to alimony or support payments.

6. Target Benefit Plans. While we agree that the treatment of target benefit plans under section 415 of the Code (relating to limitations on contributions and benefits under plans) should be improved, we recommend a change in section 4804 of S.1541. In our opinion, the plan sponsor of a target benefit plan should be allowed to elect whether the plan will be subject to the defined benefit or defined contribution limitations of that section.

7. Plans Funded With Deferred Annuity Contracts. We recommend including in S.1541 a provision that would exempt pension plans funded with deferred annuity contracts from the minimum funding standards (and the enrolled actuary requirement) of ERISA where all plan benefits are purchased (and guaranteed) as they accrue.

8. Unrelated Debt-Financed Income. We oppose section 4806 of S.1541, which would amend the Code to provide that policy loans received by a trustee of a qualified plan do not

give rise to taxable debt-financed income.

1. Reporting and Disclosure

We generally support the changes in the reporting and disclosure requirements of ERISA that are proposed in Subtitle B of Title III of S.1541. We believe, however, that the Congress should make further improvements in this area.

ERISA has come to be viewed by many plan sponsors and potential plan sponsors as, in Samuel Johnson's words, "a conspiracy for the destruction of paper." Although it is difficult to appreciate fully the reporting and disclosure requirements of the Act without attempting to comply with them oneself, the following tables provide a brief summary of these requirements:

SUMMARY OF REPORTING REQUIREMENTS

ITEM	DUE DATE	TO BE FILED WITH
(For 1978 and Subsequent Years)		
1. Annual Return/Report . . . IRS/DOL/PBGC: Form 5500 Series (5500, 5500-C, & 5550-K)	7 months after close of plan year.	IRS
2. Annual IRS/Registration Statement: Schedule SSA	No later than 7 months after close of plan year following the plan year in which participant separates from service; not required if before end of latter plan year, participant is paid his benefit, returns to service, or forfeits deferred vested retirement benefit.	IRS, with Form 5500
3. Schedule A-Insurance Information and Schedule B -- Actuarial Information	7 months after close of plan year.	IRS, with Form 5500
4. Plan Description: Form EBS-1	In 1979 the DOL eliminated the Plan Description Form EBS-1. The filing of a copy of the summary plan description with the DOL enables plan sponsors to comply with ERISA's plan description filing requirements.	
5. Summary Plan Description	For new plans 120 days after plan is subject to provisions of Part I of Title I of ERISA. Periodic update, once every 5 years if plan is modified and once every 10 years regardless of change.	DOL

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	ITEM	DUE DATE	TO BE FILED WITH
6.	Material Modifications to Plan and hence, Modifications to Summary Plan Description	210 days after close of plan year in which modification is adopted, unless incorporated in timely filed Summary Plan Description.	DOL
7.	Form 5310 and Actuarial Statement in the case of a Plan Merger, Consolidation, or Transfer of Plan Assets and Liabilities	30 days before merger.	IRS
8.	Form for PBGC Insursurance Premium Payments Form PBGC-1	7 months after close of plan year.	PBGC
9.	Form for Reportable Event where 30-day notice not waived	30 days after plan administration knows or has reason to know of reportable event.	PBGC
10.	Notice of Intent to Terminate	10 days before proposed termination.	PBGC

SUMMARY OF DISCLOSURE REQUIREMENTS TO PARTICIPANTS AND BENEFICIARIES

ITEM	PROVIDED BY	MADE AVAILABLE	DUE DATE
1. Summary Plan Description	Pension and Welfare Plans.	Automatically made available.	For new plans: 120 days after the effective date of the plan, or the adoption date if later. A new participant receives an SPD either 90 days after first becoming a participant or upon first receiving benefits, whichever is earlier. A periodic update of the SPD is done every 5 years if the plan is modified, and once every 10 years regardless of changes.
2. Summary Description of Material Modification	Pension and Welfare Plans.	Automatically made available.	210 days after the close of the Plan Year in which the modification is adopted.
3. Summary of Latest Annual Report	Pension and Welfare Plans. Unfunded or insured welfare plans covering less than 100 participants are exempted.	Automatically made available.	9 months after the end of the Plan year or within 2 months after the close of the extension period for filing the annual report.
4. Explanation of Joint and Survivor Annuity	Pension Plan covered by qualified joint and survivor rules.	Automatically made available.	For most plans, 9 months before the participants' qualified early retirement age. For further clarification, see Treas. Regs. §401 (a)-11 (c)(3).

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ITEM	PROVIDED BY	MADE AVAILABLE	DUE DATE
5. Individual Deferred Vested Pension Statement	Pension Benefit Plans.	Automatically made available.	7 months after the end of the Plan Year or 2-1/2 months after the 7 months if an extension is made available.
6. Explanation of Claims Denial	Pension and Welfare Benefit Plans.	Automatically made available.	90 days after such claim is filed.
7. Personal Statement of Accrued and Vested Benefits	Pension Benefit Plans.	Only upon written request.	Within 30 days of such written request, and only once every 12 months.
8. Latest Form 5500 (Annual Report)	Pension and Welfare Plans. Unfunded or insured plans covering less than 100 participants are exempt.	Available for viewing, and a copy is available upon written request.	Within 30 days of the participant's written request.
9. Plan Documents, Trust Agreements, Bargaining Agreements, Contracts, Legal Documents, etc.	Pension and Welfare Benefit Plans.	Available for viewing, and a copy is available upon written request.	Within 30 days of the participant's written request.
10. Terminal Reports	Pension Benefit Plans	Only upon written request.	Within 30 days of the written request, but only after the terminal reports have been filed with the DOL.

The enormous ERISA paperwork burden is not, as some suggest, an unqualified benefit to participants. The General Accounting Office has found, in a study of ERISA's effects on small plans, that the average cost of reporting to Government agencies increased 403 percent, and the average cost of reporting to employees increased 369 percent, with the enactment of ERISA.*/ Not only are these costs borne in part by current plan participants; they also discourage the formation of new plans for employees not now covered.

Nor is it an answer to these problems to suggest that plan sponsors can simply adopt a Simplified Employee Pension plan, which requires less paperwork than other types of plans. First, and most obviously, plan sponsors should not be forced to adopt a particular type of plan out of the many types that are legally permissible in order to avoid unnecessary paperwork. Second, the SEP plan offers considerably less flexibility than other tax-qualified arrangements. For instance, the available investment vehicles for SEP plans are limited. Some of the best investments that other tax-qualified plans have made in recent years, such as indirect ownership of real estate (often through pooled funds) and investments in private placement debt obligations, are not available to SEP plans. Similarly, the maximum limit on contributions to SEP plans is substantially lower than for other tax-qualified arrangements. In practice, the higher contributions that are allowed under other types of plans provide much greater incentive for key employees to establish plans which, once established, benefit rank-and-file employees as well.

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*/ Comptroller General of the United States, Effects of the Employee Retirement Income Security Act of 1974 on Pension Plans With Fewer Than 100 Participants, at 21-25 (April 16, 1979). The increase in costs for larger employee benefit plans is not reflected in these data.

Thus, in our view, it is in the interest of all parties to plans for the Congress to weigh, in light of seven years' experience under ERISA, the costs and benefits of each of ERISA's reporting and disclosure requirements, and to improve or eliminate those requirements that have not proven cost-effective.

As noted above, we generally support the proposals in Subtitle B of Title III of S.1541. In the discussion that follows, we offer specific comments on certain of the proposals in S.1541, and then make specific recommendations for additional changes in ERISA's reporting and disclosure requirements.

a. Reliance by Actuaries and Accountants on Each Other's Opinions

We strongly support section 3202 of S.1541, which would require, rather than merely permit (as under current law), actuaries and accountants to rely upon each other's opinions in their review of a plan. This change will clarify the role of each type of professional and avoid the expense of duplicative auditing procedures.

b. Distribution of Summary Plan Description

We support the proposal in section 3206 that would extend from five to 10 years the interval for filing and distributing an updated Summary Plan Description where there has been a change in the terms of a plan. This proposal would not change the requirement of current law that participants be provided an SPD, with updates, when they begin covered employment, nor the requirement that they be provided statements of material modifications in the plan after the close of the plan year in which they occur. Thus, in view of the fact that the information that is included in an updated SPD has already been provided to participants, the change proposed in section 3206 is quite sensible.

c. Publication of Summary Annual Report

In the discussion below, we outline a proposal for eliminating the Summary Annual Report and making a simplified Annual Report available to participants instead. However, if the SAR is not eliminated, we favor the proposal in section 3207 of S.1541 that would eliminate the requirement that the SAR be distributed to every participant, and require instead that a revised SAR be posted at principal work sites of employee participants.

d. Simplification of Notice Regarding Determination Letters

Under section 3208 of S.1541, the requirements relating to notice to interested parties regarding tax-qualification proceedings are simplified to require notice to employees by posting (or alternative means of publication under regulation), together with notification to the appropriate collective bargaining representative.

We recommend instead that this notice requirement be completely eliminated. Experience has shown that the required notice provides little or no benefit to the interested parties, while imposing substantial costs on plan sponsors. In addition, we do not believe that a change in the content of the required notice would make it more useful since the tax-qualification process is inherently technical and esoteric.

e. Recommendations for Additional Changes In ERISA's Reporting and Disclosure Requirements

A. Annual Report

Description of Problems

ERISA requires generally that an Annual Report be filed with the Government (and made available for inspection by participants) with respect to every employee benefit plan. The list of items required to be included in the Annual Report consumes over five pages of the statute. Although the Secretary of Labor is authorized to prescribe alternative methods of satisfying ERISA's reporting and disclosure requirements, the Department of Labor has instead generally applied the statutory requirements. Relief provided by the Department has been inadequate and piecemeal.

The current Annual Report for larger plans requires at least 220 separate answers and items of information, plus, in many cases, lengthy attachments with complex data and calculations. Smaller plans must file a report every three years with 90 - 180 items of information, and a different report in intervening years.

In all, over 1,000,000 Annual Reports are prepared and filed with the Government each year. The cost to the private sector each year of preparing the ERISA Annual Report is easily in the hundreds of millions of dollars.

In spite of the enormous cost and burden involved in preparing and filing the Annual Report, much of what is required to be included in the Annual Report is of little or no use to participants, beneficiaries or the Government. For example, the schedule of specific plan investments that is required to be attached to the Annual Report for larger plans provides such voluminous and detailed information that both participants and the Government usually find it unenlightening and overwhelming. Providing investment information in this form is not only a costly burden for plans and employers; it also supplants useful questions and information on the same subject.

Perhaps the best evidence that the ERISA Annual Report needs to be changed is a recent study by the General Accounting Office which found overwhelming evidence that the Government is not using much of the information in the Annual Report. For instance, the Study found that where questions on the form were not answered by the person filing the form, the Government usually did nothing to obtain the missing information.*/

We believe that, because the Government requires so much detailed information, it is unable to use any of the information quickly or effectively. We understand that there is often a delay of several years before the data on the reports is entered into a computer and that, even when entered, the data is seldom effectively utilized.

Proposed Solution

In our view, the Annual Report can be reduced to a document of a few pages, and it will be a more useful document to both the Government and plan participants as a result. We have included in the appendix to this testimony specific recommendations as to the content of a revised Annual Report, together with a discussion of our reasoning with respect to each item. Besides shortening the current Annual Report, we have recommended that the redesigned Annual Report take the place of two other reports, the Summary Annual Report and the PBGC-1. Thus, our proposal is actually a consolidation of three separate reports.

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*/ Comptroller General of the United States, Better Management of Private Pension Plan Data Can Reduce Costs and Improve ERISA Administration, at 16-20 (October 19, 1981).

In developing recommendations for changes in the Annual Report and related documents, we have applied the following general principles:

(1) It is essential that changes not be made in the Annual Report, or any ERISA document, unless those changes are substantial. Typically, it costs more to reprogram computers, retrain employees, and set up new filing systems than is saved by small changes.

(2) The information that is included in the Annual Report should, first of all, be information that would be useful to participants, and, second, be designed to alert the Government to problem areas. Where problems are indicated, the Government can examine the plan more closely.

(3) The Annual Report should, wherever possible, require simple answers that do not require extensive research or extensive attachments.

(4) The Annual Report should generally not require reporting of information that has already been reported in other documents.

(5) The Annual Report should require information that is mainly useful to the Government, rather than participants, only if (A) the information is likely to be used systematically by the Government (the best evidence of this being that is has been used systematically by the Government in the past), (B) more cost-effective alternative means of gathering the information, such as audits or statistical surveys, are not feasible, and (C) the information is not likely to alarm or confuse participants.

Of course, reasonable people can differ on exactly what should be included in a shorter Annual Report. We believe, however, that specific recommendations need to be made in order to stimulate a constructive debate of these issues. In addition, we believe that constructive debate of these issues would be furthered if Congress requested the relevant agencies, which may have information that is not available to us regarding the relative enforcement value of different types of information, to develop a specimen Annual Report that is no longer than the one proposed in the appendix to this testimony and that will not require additional attachments.

B. Summary Annual Report

Description of Problems

ERISA requires generally that a summary of the financial and other information required to be reported to the Government in the Annual Report also be furnished annually to every participant and certain beneficiaries of every employee benefit plan. This document is quite expensive for plans to prepare and distribute. For example, one large multiemployer plan of which we are aware spends $150,000 annually preparing and mailing the Summary Annual Report.

Experience has shown that, while a few participants may find the information disclosed in the SAR to be of interest, most do not, and many in fact find it confusing or alarming. Thus, the major expense involved in preparing this separate document and then providing it to every participant serves little useful purpose, and in fact is counterproductive in many cases.

Proposed Solution

We recommend that the Summary Annual Report be eliminated. However, in lieu of the Summary Annual Report, we recommend that employers be required to prepare a simplified Annual Report of the type that we have described above. Plan sponsors should be required to make the new simplified Annual Report readily available to participants, but should not be required to distribute it to each participant individually.

Under this proposal, two major burdens and expenses for plans and employers would be eliminated. First, the considerable burden and expense of preparing a separate SAR each year for participants would be eliminated. Second, the additional burden and expense of distributing the SAR to every participant would also be eliminated. At the same time, interested participants would have ready access to a revised Annual Report that would be designed to provide them with important information in a usable form.

C. Summary Description of Material Modifications in Plan and Changes in Plan Description

Description of Problems

ERISA generally requires that once the Summary Plan Description has been distributed, the plan administrator must provide participants and beneficiaries with summary descriptions of any material modifications in plan terms, and changes in information contained in the summary plan description. This document must be distributed following the close of each plan year in which such a modification or change occurs.

Plans have in the past been given little guidance as to what constitutes a "material" modification, and the little guidance that has been provided has been over-inclusive in its interpretation of what constitutes a material modification.

Proposed Solution

We suggest that specific requirements be included in ERISA as to the types of changes that must be disclosed in the description of material modifications in the plan and changes in the SPD. In particular, material changes in the following should have to be summarized in the description of material modifications:

(1) Type of plan (pension, welfare, defined benefit, defined contribution)
(2) Coverage by PBGC
(3) Participation requirements
(4) Vesting requirements
(5) Accrual requirements

(6) Forfeiture provisions (including break-in service rules)
(7) Basis for computing benefits
(8) Disposition of employee contributions
(9) Procedures for presenting claims
(10) Name and address of sponsor/employer
(11) Structure of plan (multiemployer, single employer)
(12) Agent for service of process

This would provide specific guidance as to what constitutes a "material" modification and exclude from the list of material modifications items that would not typically be useful to a participant in retirement planning.

In the discussion which follows, we outline our positions on a number of provisions in S.1541 that relate to matters other than reporting and disclosure under ERISA.

2. Joint and Survivor Annuity Requirements

We strongly support the amendments proposed in section 3309 of S.1541 that would, first, eliminate major problems in the application of the joint and survivor annuity rules to defined contribution plans, and, second, relieve plans that provide an equivalent pre-retirement death benefit from the pre-retirement joint and survivor annuity requirements. These changes would eliminate unnecessary costs and burdens without diminishing survivor protections under ERISA.

Under section 205 of ERISA and section 401(a)(11) of the Code, a retirement plan that provides for the payment of annuity benefits must provide for the payment of such benefits in the form of a qualified joint and survivor annuity. A qualified joint and survivor annuity is an annuity paid, upon the participant's death, for the life of the participant's spouse (equal to at least one-half of, but no greater than, the participant's annuity).

Under Treasury Department regulations, a plan that has an annuity option must provide retirement benefits in the form of a qualified joint and survivor annuity unless the participant elects otherwise. Plans that provide early retirement benefits are also required to offer participants who continue in employment after early retirement age an opportunity to elect survivor coverage while they are still employed. Detailed procedural requirements must be met in connection with both the post- and pre-retirement elections.

As interpreted by Treasury Department regulations, ERISA requires profit-sharing and other defined contribution plans that contain an annuity option to be restructured to make a joint and survivor annuity the primary form of benefit under the plan.*/ This is true despite the fact that the vast majority of participants under these types of plans choose to receive their vested benefits in the lump sum form. In order to avoid the substantial administrative costs related to annuity options which are used by a relatively small group of plan participants, many plan sponsors have simply eliminated all annuity options. This means, of course, that participants who desire an annuity will no longer have that option, a result which is totally contrary to the purpose of joint and survivor provisions.

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*/ See paragraph (a), §1.401(a)-(11). This provision was declared invalid in a unanimous decision of the Tax Court which has been affirmed by the U.S. Court of Appeals for the Third Circuit. BBS Associates, Inc., 74 T.C. No. 83 (August 26, 1980), aff'd without opinion, No. 80-2851 (3d Cir. July 29, 1981). The IRS has not acquiesced in this decision.

Thus, we strongly support the change proposed in section 3309 of S.1541 that would eliminate the costs and burdens of complying with these requirements (and encourage annuity options) in defined contribution plans that provide that a participant's vested account balance is payable upon death.

A second major problem in this area involves the application of the early survivor annuity aspect of the joint and survivor annuity rules to defined benefit insurance contract plans and similar plans that provide a pre-retirement death benefit that equals or exceeds the minimum requirement of ERISA. Even though these plans provide an equivalent death benefit, the benefit may not satisfy the technical definition of a "survivor annuity." As a result, these plans are required to comply with unnecessary joint and survivor notice and election requirements.

In order to remedy this problem, we support the change proposed in section 3309 of S.1541 that would relieve plans (where the death benefit is at least the actuarial equivalent of a survivor annuity) from the pre-retirement joint and survivor requirements. However, we suggest a technical change in the language of that provision that would assure that the provision accomplishes its intended simplification objective.

The bill language that concerns us is proposed ERISA section 205(c)(3)(B) that would be added by section 3309(a) of S.1541. That provision states, as one condition for exemption from the pre-retirement joint and survivor annuity requirements, that "the plan allows the participant to elect to have the death benefit paid in the form of such a survivor annuity" (emphasis added). The purpose of this provision is to assure that the spouse or other beneficiary may have the pre-retirement death benefit paid in the survivor annuity form (in addition to other permissible forms).

However, we are concerned that the reference to the "plan" may actually require that plans be amended even though the insurance or annuity contracts funding the plan provide the same annuity rights as a settlement option. In addition, we are concerned that the use of the term "elect" could be interpreted by the Government as a basis for resurrecting the panoply of joint and survivor annuity election problems that the provision is intended to eliminate in the first place. For these reasons, we recommend that proposed ERISA section 205(a)(3)(B) read instead as follows:

> "(B) the death benefit may be paid in the form of such a survivor annuity."

3. 4/40 Vesting Safe Harbor

We strongly support section 4810 of S.1541, which would confirm and clarify the relationship between plan vesting schedules and nondiscrimination requirements of the Code, and generally insure that plans with so-called "4/40" vesting would qualify for tax purposes.*/

Prior to the enactment of ERISA, plans were not generally required to provide pre-retirement vesting. One of the major reforms of ERISA was the inclusion (in section 204, and Code section 411) of three minimum vesting schedules. That decision, and the exact form the new minimum standards would take, was one of the most widely discussed issues during ERISA's development. In providing the minimum vesting standards, Congress recognized that --

> it would be counterproductive to increase employer costs by more rapid vesting to such an extent as to significantly curtail the creation of new retirement plans (or to significantly curtail the increase in benefits in existing plans).**/

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*/ Under "4/40" vesting, generally, a participant vests in 40 percent of his accrued benefit after four years of covered service and acquires additional vesting credit each year thereafter until he is 100 percent vested after 11 years.

**/ H.R. Rep. No. 807, 93d Cong., 2d Sess., 53-54 (1974).

Both before and after ERISA, a separate provision -- section 401(a)(4) of the Code -- has prohibited discrimination in favor of officers, shareholders or highly compensated employees with respect to contributions or benefits. This provision is referenced in section 411(d)(1) of the Code, which provides that a plan which satisfies one of the three minimum vesting requirements shall also be treated as satisfying the nondiscrimination requirements of section 401(a) of the Code, unless --

> (A) there has been a pattern of abuse under the plan (such as dismissal of employees before their accrued benefits become nonforfeitable) tending to discriminate in favor of employees who are officers, shareholders, or highly compensated, or
>
> (B) there has been, or there is reason to believe there will be, an accrual of benefits or forfeitures tending to discriminate in favor of employees who are officers, shareholders, or highly compensated. (Emphasis added.)

The amendment proposed in section 4810 of S.1541 would continue to allow the Government, in interpreting and enforcing Code section 411(d)(1), to require faster vesting than the three general vesting schedules provided under ERISA and the Code. However, it would clarify, in accordance with the intent of the Conference Committee on ERISA, that the "4/40" vesting schedule is a "safe harbor" that would protect against a finding of discriminatory vesting under Code section 411(d)(1) except where actual abuse in practice (such as firing employees to prevent them from vesting) is found. This provision, unlike recently proposed regulations (Proposed Regulation §1.411(d)-1 under Code section 411(d)(1)), is consistent with the legislative history of ERISA.

Thus, we support the amendment proposed in section 4809 of S.1541. We believe this change would provide employers the certainty they need regarding the ongoing tax-qualification of the plans that they sponsor -- certainty that is especially important in facilitating business planning by small employers. In addition, we support the change proposed in section 4809 as a means of attaining uniformity in the application and enforcement of vesting standards -- an important objective of Congress in enacting ERISA. Finally, we believe that approval of 4/40 vesting as a safe harbor is essential to the continued maintenance and growth of small plans.

4. Faster Amortization of Past Service Liabilities

In our opinion, one key element in the expansion of the private pension system, especially with respect to coverage of employees of small businesses, is providing adequate tax incentives for the establishment and maintenance of new plans. Thus, we support section 4808 of S.1541, which would allow employers to fund past service costs over five years, rather than 10 years as permitted by current law.

We also urge the Subcommittee to consider providing more liberal tax incentives for new plans, such as allowing employers to make deductible contributions for their full past service costs in the first year that past service credits are provided under a plan (or over more than one year, but over a shorter period than allowed by current law or section 4808 of S.1541). We believe that such a rule would be desirable and appropriate for a number of reasons.

First, the ability to obtain an immediate deduction for contributions covering all or a large part of past service costs would be an important incentive for small employers to establish pension plans. Second, the experience of the PBGC has been that many plans that are in danger of terminating are underfunded because past service liabilities were never properly provided for. It is only common sense, therefore, to encourage the full funding of plans rather than to impede full funding.

Third, additional funding flexibility is particularly helpful to small employers because they tend to be very concerned about the effect of year-to-year fluctuations in their economic fortunes on their ability to handle long-term commitments.

Finally, the suggested treatment is probably more consistent with established tax principles than the current rules. Since a 1930 Supreme Court decision, it has been well-settled that the payment in one year of a reasonable amount of additional compensation for services performed in previous years (during which there was a legal obligation to pay for such services) is deductible in the year of payment to the extent the compensation for the services is reasonable in view of the benefits the employer received from the services.*/ The deduction limitations of the Code were originally developed in 1928 (while this issue was working its way through the courts) and were based upon narrow revenue concepts under which pension plans were viewed in large part as tax shelter devices. A reconsideration of these rules, especially in the context of plans of small employers, would seem to be required in view of the pressing need for expansion of the private pension system in the United States.

5. Alimony and Support Payments

We strongly support the enactment of comprehensive and uniform Federal legislation substantially along the lines of section 3310 of S.1541. This provision would permit in appropriate circumstances enforcement against plans of court orders relating to alimony or support payments. It would strike a reasonable balance between the needs of family members to reach the pension benefits of employees in appropriate circumstances, and the strong need for clear and workable rules upon which plans and others can rely. However, some of the provisions of this section might be improved from a technical standpoint. (For example, we believe it is important that the bill make it clear that the fact that a former spouse may have a right to a participant's pension benefits does not make that spouse a "participant" for ERISA purposes.) We would be pleased to work with the Subcommittee and its staff on such improvements.

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*/ See Lucas v. Ox Fibre Brush Co., 281 U.S. 115, 50 S.Ct. 273 (1930).

The problems which have arisen in this area have been the subject of extensive and costly litigation and have resulted in great uncertainty for those associated with pension plans, including life insurance companies that provide investment and administrative services for plans. The uncertainty as to the legality under ERISA of compliance with court orders that would require payment of benefits to individuals other than the individuals who would be paid the benefits under the terms of a plan, as well as the possible adverse effect that compliance could have on tax qualification, have put plans and others in an untenable position. These difficulties are especially pronounced where, as commonly occurs, family support orders or community property settlements conflict with the express terms of a plan, purport to alter the obligation of the plan to covered participants, or are vague as to the amount or duration of the payments to be made to the spouse or dependents.

In addition, plans and service providers such as life insurance companies have been faced with the risk of fiduciary liability, the possibility of double payment of benefits, and the substantial cost of appearing through counsel in family court proceedings.

A provision along the lines of section 3310 of S.1541 would eliminate the uncertainty and waste under current law through reasonable and detailed rules that address each of the specific problems that have vexed participants, plans, service providers and the courts. We believe that all of the affected parties would be well served by improvements of this type.

6. Target Benefit Plans

Under Code section 415, the amount of benefits that may be paid under a defined benefit plan, and the amount of contributions that may be made to a defined contribution plan, are subject to specified limitations. "Target benefit plans," which are generally designed with the objective of providing a specified benefit to participants but do not promise to do so, are currently treated as defined contribution plans for purposes of Code section 415. The amendment proposed in section 4804 of S.1541 would subject newly-established target benefit plans to the Code section 415 limitations for defined benefit plans rather than defined contribution plans. For the reasons below, we recommend that the plan sponsor of a target benefit plan be allowed to elect whether the plan will be subject to the defined benefit or defined contribution limitations of Code section 415.

Target benefit plans can be an attractive vehicle for providing retirement benefits, especially in the case of small employers, because, unlike defined benefit plans, they do not involve PBGC premiums and employer liability or the considerable expense of periodic actuarial valuation and certification, and because the contributions to target benefit plans can be level and predictable.

Applying the defined benefit limitation to target benefit plans, as proposed in S.1541, should make target plans more attractive to older participants, since greater benefits could be provided to older workers than under current law. This change would be helpful to many businesses, especially smaller ones, which are not in a position financially to support a retirement plan until the business has "matured" -- by which time the business' employees may have grown older as well.

On the other hand, the change could discourage the adoption of target plans in certain other common situations. For example, because the Internal Revenue Service requires that relatively conservative assumptions be used in computing target benefits, it is possible for more money to be accumulated in the plan for a younger participant than can be applied to purchase the maximum benefit available under the Code section 415 defined benefit limitation when the participant retires.

Thus, while we agree that the treatment of target benefit plans under Code section 415 should be improved, we recommend that the plan sponsor of a target benefit plan be allowed to elect whether the plan will be subject to the defined benefit or defined contribution limitations of Code section 415. In order to protect against manipulation, we recommend that this election be irrevocable and be made available to existing target benefit plans upon enactment (as it would be under the bill) and to newly established target benefit plans.

7. Proposal to Exempt Pension Plans Funded Solely with Group Deferred Annuity Contracts from ERISA's Minimum Funding Requirements

The bill includes at least one provision (section 3402) that would simplify and reduce the cost to plans of complying with the minimum funding standards of ERISA. That provision of the bill would eliminate the requirement of prior IRS approval of a change in a plan's funding method or plan year (except where more than one change is made during any three-year period).

While we generally endorse this proposed change, we recommend that the Subcommittee adopt an additional proposal in the funding area that would simplify ERISA and reduce costs for a relatively significant segment of plans funded with life insurance companies. Specifically, we recommend that ERISA be amended to exempt plans funded solely with group deferred annuity contracts from the minimum funding requirements where such plans do not have any unfunded past service costs. The adoption of such a proposal would reduce administrative costs for these plans by eliminating the need to hire enrolled actuaries and to comply with reporting requirements related to the minimum funding rules.

The group deferred annuity contract was the first product that life insurance companies developed to provide a method of funding pension benefits on a group basis (as opposed to issuing an individual contract for each plan participant). The principal feature of such a contract is that the employer funds the plan by purchasing from the insurer, on an annual basis, the annuity benefit that is needed to provide each plan participant with the fixed benefit that he or she earned in the plan year. Once this unit of annuity benefit has been purchased by the employer, the life insurance company is obligated to provide the participants with the benefits they have earned to date (to the extent that participants are vested). Thus, in contrast to many of the pension funding arrangements commonly used today where plan funds are not allocated or set aside for particular participants, the only risk that participants in group deferred annuity plans assume (with respect to benefits already purchased) is the extremely remote one that the life insurance company will become insolvent before all annuity payments have been made.

Traditionally, all of the annuity premium and other actuarial calculations under these plans have been made by the insurers pursuant to the contracts. Accordingly, in the past, it was not necessary for employers maintaining these plans to hire, at additional expense, enrolled actuaries. ERISA changed that, however, and under present law, an enrolled actuary must be retained to provide the necessary certification, complete the Schedule B to the Form 5500, and perform the other tasks required of plans subject to ERISA's minimum funding requirements.

The substantial benefit security that group deferred annuity contract funding provides to plan participants results in less flexibility in employer funding, investment alternatives, etc.; accordingly, relatively few new plans are being established under these types of contracts today. However, the life insurance industry has, over the years, built up very large reserves under such contracts and we believe that thousands of pension plans are currently being funded solely with group deferred annuity contracts.

In our view, there is no substantial legal or policy reason why plans funded solely with group deferred annuity contracts should continue to bear the additional expense that arises from the application of ERISA's minimum funding rules, at least where the employer is funding all plan benefits on a current basis (i.e., no unfunded past service costs have to be amortized). In such cases, insurers are clearly able to calculate the actuarially-required premiums, etc., on an annual basis. Moreover, to the extent that a plan's experience indicates that the premiums already paid (plus interest) are in excess of the amount needed to fund existing benefits, the excess premiums are returned to the plan and, historically, have been applied to reduce the premium payable by the employer in the next plan year. Thus, under these plans, all funds are immediately applied directly, or indirectly through the excess premiums returned (referred to as dividends or rate credits), to provide guaranteed benefits to participants.

Our proposal to exempt such group deferred annuity contract plans from ERISA's minimum funding standards (and the related actuarial and reporting requirements) is consistent with the policies reflected by the existing funding exemption (see ERISA section 301(b) and Code section 412(i)) for plans funded with level premium insurance or annuity contracts. That exemption recognizes that where plan benefits are systematically being funded by the employer on a current basis (pursuant to the premium calculations made by the insurer under the contracts), and the benefits are fully guaranteed by a life insurance company, there is no need to have the minimum federal standards apply to the plan. Moreover, the enactment of this proposal would benefit the thousands of group deferred annuity contract plans in existence today by simplifying ERISA compliance for the employers maintaining these plans, and by reducing their administrative costs so as to make additional funds available for employers to improve pension benefits or to provide or improve other employee benefits.

Accordingly, we urge the Subcommittee to amend ERISA to provide an exemption from the minimum funding rules and the actuarial engagement and certification requirements (section 103(a)(4)) for plans that satisfy the following requirements:

(1) The plan is funded solely through a group deferred annuity contract;

(2) The annual premium required under the contract for the purchase of benefits accruing during the plan year is treated as the normal cost of the plan for that year, and no additional premium is payable for supplemental benefits or for benefits accruing during such plan year or any prior plan year; and

(3) The premium payable under the contract for the plan year, and for all prior plan years, has been paid.

8. Unrelated Debt-Financed Income--Life Insurance Contract Policy Loans

Section 4806 of S.1541 would amend section 514(c) of the Code to provide that policy loans received by a trustee of a qualified plan do not constitute debt-financed property on which there is an acquistion indebtedness. Under this provision, income earned from the investment of such loan funds would not be subject to the tax on unrelated business income.

We oppose this provision. For no apparent reason, it would treat a particular type of indebtedness as not giving rise to unrelated debt-financed income under the Code. It would also have a severe adverse effect on life insurance companies selling ordinary life insurance to qualified plans.

Conclusion

The five companies sponsoring this testimony appreciate the opportunity to present our views on the important issues before this Subcommittee, and to voice our strong support for many of the proposals included in S.1541. We believe that Congress has an opportunity, in light of seven years' experience under ERISA, to improve substantially the rules governing the private employee benefit system of the United States. We commend the Subcommittee on its efforts in this area, and would be happy to furnish any additional information that the Subcommittee would find useful in its deliberations.

APPENDIX

Proposed Changes In ERISA Annual Report

In the discussion below, we describe in detail our proposal for changes in the ERISA Annual Report. The form reproduced immediately below is a specimen of the Annual Report (Form 5500, 5500-C and 5500-R) as it would appear if revised according to our suggestions. It is important to note that, unlike the current versions of the Annual Report forms, our proposed form would generally not require any additions or attachments except for the schedules contained in the form package (Schedules B and SSA) and the additional actuarial information required by Schedule B. Thus, the specimen forms, when completed for filing, will be much shorter than the forms currently in use.

A detailed explanation of our proposed changes in the Annual Report follows our Proposed Annual Report. The current Forms 5500 and 5500-C are reproduced at the end of this appendix.

(Note: In the interest of economy, the material referred to above was retained in the files of the committee due to its voluminous content where it may be researched upon request.)

Senator NICKLES. Thank you very much.

Mr. Groom, you mentioned a much smaller annual report, and I see the report that you have. I think you said it was 160-some pages—is that a 5500 form for a major employer?

Mr. GROOM. Yes, it is.

Senator NICKLES. How many participants, just roughly, are in the plan?

Mr. GROOM. Possibly, 100,000.

Senator NICKLES. You stated that we might be able to replace that voluminous report with a report that would be two or three pages?

Mr. GROOM. Yes.

Senator NICKLES. Basically, I guess, in your summary—and I have not seen your simplified report—but it would say number of participants, assets, and liabilities, increase in assets and increase in liabilities.

Mr. GROOM. Let me give you an example. It would be much shorter. For example, a big part of the bulk of this form is a listing of each individual investment—this many pages—it lists each investment that the plan makes by name and number of shares and inventory value and market value. We would replace that by a very brief summary of the portion of the plan's assets that are invested in particular types of investments. That change alone would save these plans from having to file all of this extra documentation.

Senator NICKLES. Does the present 5500 form require that each individual investment that is made in stocks, bonds, et cetera, show the purchase price, market price, plus or minus valuation, for that particular period of time?

Mr. GROOM. Yes.

Senator NICKLES. So your simplified form would basically say at the beginning of the year, asset value in stocks was *x* amount, this year it is this amount, maybe a percentage of the total of the valuation?

Mr. GROOM. Yes.

Senator NICKLES. I am very interested in that, and I might let other people know, too, that as far as reporting and disclosure, that is a possible improvement we might be able to make. I think it is quite possible we can make further improvements over what we have, as introduced. We are very, very receptive to input from individuals with expertise in that area.

Mr. Moran, were you wanting to comment on that?

Mr. MORAN. I would just like to say "Amen." I think you are addressing that appropriately, particularly because what you are doing is suggesting that you would take the bulk of the reporting and replace it with a short summary. I think that is a very productive route to take.

Mr. GROOM. We are both in agreement, I might say, Mr. Moran and I—and I listened carefully to his testimony—that you do not want to make just a couple of little, tiny changes, because if you make just a couple of little, tiny changes, that is going to cost more in terms of everybody reprograming to do it. We think you should make changes, but make very major changes.

Senator **Nickles**. To ask you one followup question, Mr. Groom. You are talking about simplifying the annual report and then actually using that, too, for the summary annual report.

Mr. **Groom**. Exactly.

Senator **Nickles**. Would that report be given out to the employees, distributed by the employers?

Mr. **Groom**. Right. We would make it available, rather than require that it actually be distributed. If you ask yourself how many—let us be frank—most employees do not ever read these things. I do not—I met last week with a group of pension lawyers, 20 lawyers, all experts in pensions, and I said, "How many of you guys read any of these materials or ever ask for them, or know anybody who does?" Most people do not. So let us develop procedures that make them available, but do not require the expense of unnecessary distribution.

Senator **Nickles**. I think that many people would agree with that statement. There are also people who have a difference of opinion, and that is really what we are trying to do, also, is receive input before we make our decisions in the markup of the legislation.

I might mention, also, as the legislation now stands, I think it states in our bill that there would be a $10 fee or something for a person requesting such information, and it is not my intention to leave that $10 fee in. I think that is rather silly.

Mr. Moran, are banks prohibited right now from being able to collectively invest IRA's?

Mr. **Moran**. Yes; the situation is that Congress, I think to try and be clear, set up IRA's under section 408 of the Internal Revenue Code, and the securities laws permit only those plans set up under section 401 to be collectively invested. It is an anomaly in the law. I know of no other way to describe it.

Senator **Nickles**. Right now, you cannot collectively invest IRA's. You have all these new IRA's that people are wanting to start now, with the changes that we have made in the tax bill earlier this year, but yet you cannot collectively invest them, and you are going to have all these thousand-dollar accounts. How does a major bank invest those?

Mr. **Moran**. The only way a major bank would address those would be through the savings account vehicle. It would not be able to offer its services to invest in stocks, bonds, and other kinds of appropriate investment. We are foreclosed from that.

That does not mean to say that somebody cannot access these types of investments. You can do that through a mutual fund or something else. However, if your company sets up an IRA for you, and the company puts all of those individuals together, then that plan would be eligible for a bank collective investment. Whereas the poor individual who does it by himself, does not have a company commingling them and then putting them into a bank which will then collectively invest them—that individual does not have the same access.

Senator **Nickles**. Actually, you are working from two different standpoints. Can you make that much of a greater return if you collectively invest the funds, as compared to the individual investment?

Mr. **Moran**. Well, I think it is a matter of do you have the opportunity to access, as an example, a bank's expertise in the investment area. Without a collective fund, you do not, for small amounts of money. It is just an impractical amount to invest.

Senator **Nickles**. Then administratively, the cost is much greater in proportion for the individual as compared to the collective?

Mr. **Moran**. It would be. The only reason that I do not get to that is that we would not do the investment, in most cases, anyway. We would not be able to offer it, so it is not even a matter that it is not available at any cost. No matter what you would be willing to pay, it is still impractical to take those small amounts of money and invest them separately. You would not have the diversification of investment that would be desirable.

The only feasible approach is through some kind of commingled vehicle.

Senator **Nickles**. Are any legislative moves afoot right now to do something through the Finance Committee or through other committees? Has this been brought to the attention of the Finance Committee?

Mr. **Moran**. The Banking Committee has the bank mutual fund bill, which would be an approach to this. I think in my testimony, I am really saying that that is one vehicle for doing it, but you also should, for those banks who would not want to set up a mutual fund, you should do away with what I perceive is an unintended result, and permit the commingling of IRA's with H.R. 10's, with corporate plans, all of which have the same purpose of providing a retirement income to these beneficiaries and permit them to be collectively invested even if you did not have a mutual fund. For those banks that would set up a mutual fund, as envisioned by the bill before the Banking Committee now, that would solve the problem for those banks. Though if I look at the 13,000 banks I am sitting here representing, it would not solve the problem for all of those banks.

Senator **Nickles**. In your statement, you referred to the fact that the ABA requested simplified reporting for certain master trusts 3 years ago. You also mentioned the Department of Labor is now only ready to grant that. Is that a typical response from DOL?

Mr. **Moran**. Well, I guess because of the panel that you have up here, I might refer to another example. We went in several years ago for an exemption for our collective funds, to permit them to operate under standard business procedures. A little bit before us, my insurance company colleagues here had been in there for a separate account exemption, which is their vehicle for accomplishing a similar purpose. Ours, I think, pended something like 3 years, and if I remember right, yours was pending even longer than that.

Mr. **Groom**. Right. We got ours first, but ours was pending 4 years before we got it.

Mr. **Moran**. And when we got it, the biggest problem was that it really did not address the significant problems, I do not think, in either case. It was not a significant step forward even after that 3-year wait in our case, and 4 years in theirs.

I think the Labor Department has tried very diligently to be responsive. However, I think they have been too rigid in their construction of the law. I think Congress gave them much more flexibility than they have chosen to use, and as a result, I think Congress now has the problem of coming back and saying to the Labor Department, "OK, this is what we intended, and we will lead you a little bit more carefully through it this time rather than relying on you to exercise the discretion," discretion that I think was given to them.

Senator **Nickles**. A question for the panel. I think everyone on the panel urged that some changes be made in reporting and disclosure, simplification. What information do you think is actually needed by the participants and by the Department of Labor to insure that their funds are being invested in a wise and prudent manner, at least in a method to insure that abuse is actually not taking place?

Mr. **Moran**. I will start that. Two comments. First of all, I think that participants should have the ability to get a good deal of information upon request. I think that is one way to not only prevent abuse, but knowing it is available, I think is an important thing. These participants have rights, and attention should be paid to that.

I think, however, the kind of information that is the most meaningful to them is personal information. And other than knowing if the plan is in serious trouble, the financials of the plan have no personal meaning to an individual.

I think I would commend to you some of the work that the advisory council to the Department of Labor has done—advice that the Labor Department has not chosen to accept, but nonetheless, information that is out there—that goes into a good bit of this—some attempts to make suggestions on revising it. I would commend that to you.

Other than that, I would endorse Mr. Groom's comments for the most part.

Mr. **Groom**. We would, I think, in our form, for example, still include the actuarial report, which would essentially indicate, as Mr. Moran has suggested, whether or not the plan is in trouble. If you are talking about defined benefit pension plans, the investment performance of the plan does not affect the participant's benefits; it affects the employer's cost. So most participants really do not have a great interest in that. In the case of at least most defined contribution plans, the participant will get information about investments through the prospectus or other sources. We would, as I mentioned earlier, include information in the annual report that would indicate the breakdown of different categories of investments. If you have a plan that is invested 100 percent in real estate, as good as real estate is, that would seem to indicate a problem.

So we would try to reduce the amount of information on the principle that people read information when it is reduced to one page. That is a principle I have learned in dealing with Senators, that they prefer for you to describe a proposal in one or two pages, if possible.

Senator **Nickles**. I am going to shock you. I read your entire statement.

Mr. **Groom**. Well, you are new at this. [Laughter.]

Somebody said this morning, my goodness, Senator Nickles is establishing a terrible tradition; he is starting Senate hearings on time.

Senator NICKLES. Mr. Loeber, the summary annual report document, which is usually about a page or two long, why does its preparation and distribution cause you problems, and do you have any suggestions to simplify it?

Mr. LOEBER. I would rather defer that question to Mr. Groom. My area is primarily life insurance and health insurance, and I am making the Council's statement on that.

Senator NICKLES. Let me ask the panel a different question. I asked a similar question of Mr. Groom. Today, there is a simplified employee plan available at the IRS. Would you comment on this approach and how available it is and how effective and time consuming it is, as a vehicle? This is the simplified employee plan that the IRS currently has available. If you are not familiar with it, fine; we will hold the question for other people who may have dealt with it.

Mr. MORAN. There is nothing wrong with it. The intent is correct. I think the things that we have talked about today, though, from our perspective, are more important, and something like that does not alleviate these problems.

Senator NICKLES. Gentlemen, those are all the questions I have. I appreciate your participation and also your input on reporting requirements, and also, Mr. Loeber, on your questions about some of the changes that we are making in the insurance field. Your statement was very well put, and we may have additional questions for you in that field. I felt like we were gaining on it. But thank you very much. We will be back in touch with you, and possibly, we will be asking you additional questions also for the record.

Thank you very much.

[The following was received for the record:]

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December 1, 1981

The Honorable Donald L. Nickles
Chairman, Subcommittee on Labor
Committee on Labor and Human Resources
United States Senate
Washington, D.C. 20510

Re: Written Testimony on S.1541 - "Retirement Income Incentives and Administrative Simplification Act of 1981"

Dear Chairman Nickles:

This statement is submitted on behalf of the Western Conference of Teamsters Pension Trust Fund ("WCT Plan") for inclusion in the record of the Hearings of the Subcommittee on S.1541, the "Retirement Income Incentives and Administrative Simplification Act of 1981".

The WCT Plan is the largest multiemployer pension plan in the United States. The Plan currently receives contributions on behalf of more than 500,000 employees working under Teamster collective bargaining agreements with nearly 15,000 employers in 13 western states. Nearly 100,000 persons are currently receiving benefits under the WCT Plan.

As of June 30, 1981, the Plan's total assets exceeded $3.4 billion and all such assets are on deposit with The Prudential Insurance Company of America pursuant to a group annuity contract. The WCT Plan is administered by 28 trustees jointly representing management and labor pursuant to the Labor-Management Relations Act, 1947.

I. SUMMARY OF THE WCT PLAN'S POSITION ON S.1541

The WCT Plan believes that the prompt enactment of legislation along the lines of the "Retirement Income Incentives and Administrative Simplification Act of 1981" is critically important to the private pension system. While certain provisions of the bill could be improved (as recommended below), there is no doubt that such legislation is sorely needed to remedy the host of problems which plans have experienced in seven years of operation under ERISA. Moreover, S.1541 properly recognizes that the basic objectives and protections of ERISA were and remain sound since it focuses on particular areas where Congress may have overreacted to specific concerns, and on troublesome issues that may not have been readily apparent in 1974.

The WCT Plan, therefore, supports many of the provisions of S.1541. We also have some recommendations for improving certain other provisions consistent with the simplification objectives of the bill. Briefly summarized, our views on the principal provisions of interest to the WCT Plan are as follows.

1. We strongly support the proposed alternative document distribution method for multiemployer plans (sec. 1212). This provision ultimately will save the WCT Plan alone millions of dollars in administrative costs, while insuring that ERISA-required documents reach the same number or more plan participants than the distribution method used under present law (p.6).

2. We strongly support the provision of the bill (sec. 3308) that would clarify that a multiemployer plan may limit its obligation to accrue benefits for employees when their employer has failed to make the required contributions to the plan. We urge the Subcommittee to make this provision effective with the original effective date of ERISA's accrued benefit requirements (p. 15).

3. We strongly support the provision (sec. 3310) that would make family law orders and community property settlements enforceable against pension plans, but only if specific standards and procedures -- intended to minimize the imposition of added costs and burdens on plans -- are satisfied (p. 20).

4. We strongly support the proposed amendments (sec. 3601) to ERISA's enforcement provisions that would facilitate the efforts of multiemployer plans to collect delinquent employer contributions by (i) allowing ERISA delinquency suits to be brought in state courts, and (ii) providing a uniform Federal statute of limitations for such suits (p. 31).

5. We generally endorse the provision of the bill (sec. 3307) that would ensure that special rules for seasonal industries are limited in application to those plans that primarily cover seasonal workers (p. 24).

6. We generally endorse the provision of the bill (sec. 3302) that would facilitate the application of plan rules governing the suspension of benefits on account of a retiree's reemployment. We urge, however, that the application of such rules be simplified by adding a provision that would allow plans to suspend benefits for reemployment in any category of employment covered by the plan (p. 25).

7. We generally support the provision of the bill (sec. 3209) that would require plans to automatically provide benefit status reports only to deferred vested participants. We recommend, however, that this provision be revised to require multiemployer plans to provide such reports no earlier than the time required by comparable Treasury regulations under section 6057 of the Internal Revenue Code (p. 14).

8. We generally support the provision of the bill (sec. 3306) that would limit the extent to which changes in actuarial assumptions for optional benefit forms may be considered to involve reductions in accrued benefits. We recommend that it be made clear that the term "normal retirement benefit" generally refers to a plan's normal benefit form for an unmarried participant (p. 29).

9. We oppose the proposed revision (sec. 3208) to the rules governing "notice to interested parties" which, while well-intentioned, may have the effect of increasing the adminstrative burden of this notice requirement for multiemployer plans. In our view, this notice requirement should be eliminated altogether in order to relieve plans of clearly unnecessary costs and burdens. Alternatively, multiemployer plans should remain subject to present law and regulations in this area (p. 12).

10. Instead of merely changing the rules for providing summary annual report information to participants (sec. 3207), we recommend that the summary annual report be eliminated. However, if the summary annual report requirement is retained in some form, the current deadline for providing the report, i.e., 9 months after the end of the plan year, should also be retained. We also recommend that the time for furnishing participants with a summary of material modifications to the plan be extended from seven months to nine months after the end of the plan year (p. 10).

The WCT Plan's views on these issues are explained further below. We note that the WCT Plan intends to submit a separate statement of its views on certain of the fiduciary responsibility provisions in the bill when the Subcommittee holds a hearing on those provisions in late January.

II. REPORTING AND DISCLOSURE PROVISIONS

1. Alternative Distribution Method for Multiemployer Plans (Section 3212)

We strongly support the provision of the bill that would allow a multiemployer plan to adopt an alternative method of distributing ERISA-required documents to its plan participants. The enactment of this provision would resolve a critical problem for the WCT Plan and other broad-based multiemployer plans. It would save the WCT Plan alone millions of dollars in administrative costs over the coming years while ensuring that ERISA documents reach the same number or more plan participants than the methods used under present law.

The problem that is addressed by section 3212 arises from Labor Department regulations which prescribe various methods for furnishing ERISA-required documents to plan participants. 29 C.F.R. §2520.104b-1(b)(1). As applied to the WCT Plan, these regulations effectively require the Plan to mail ERISA documents to plan participants at their "home addresses". This requirement may seem reasonable enough in theory, but it has imposed costly and impossible burdens on the WCT Plan (with 500,000 covered employees working at tens of thousands of locations across the western United States) and, we believe, other large multiemployer plans.

Since these regulations were issued early in 1976, the WCT Plan has spent millions of dollars in its efforts to collect and maintain an accurate "home address" file for its more than 500,000 covered employees. These efforts have taken various forms, including the distribution of address information cards, notices in union periodicals, etc., but many participants have never responded at all. Indeed, notwithstanding these substantial efforts, the WCT Plan still has current addresses only for approximately 50 percent of its covered employees and terminated participants.

The problems of establishing an initial "home address" file have been substantial and quite discouraging to the WCT Plan. However, the difficulty and expense of maintaining accurate address information on an on-going basis have been even more staggering. Some of the reasons are as follows:

- If only one of every five plan participants moves each year, more than 100,000 home addresses need to be updated annually.
- Scores of thousands of persons join or leave the WCT Plan each year so that, as a practical matter, the number of persons for whom home address records must be maintained now approaches 1,000,000.

- A substantial segment of WCT Plan participants is employed in the food processing industry where multiple address changes in a year are very common, and some persons may not actually have a "home address".

In view of these and other problems, the annual maintenance cost of the WCT Plan's "home address" file has been estimated at nearly $750,000 a year, including the salaries of nine persons who are primarily responsible for maintenance of the file. In addition to these expenses, the cost of mailing ERISA documents has continued to increase to the point where the cost of postage alone for a single ERISA mailing now approaches $100,000. In our view, the imposition of these tremendous costs and burdens is inconsistent with the purpose of ERISA -- more and more of each $1 in contributions must be used to pay for the costs of administration instead of paying benefits to plan participants and beneficiaries.

Section 3212 of S.1541 reflects a carefully-tailored solution to these problems. Under that section, the employer trustees and union trustees of a plan could agree that the plan should furnish sufficient copies of ERISA documents to the contributing employers and/or union representatives of employees who, in turn, would actually furnish the documents to participants. Significantly, this alternative distribution method could be adopted only if the employer trustees and union trustees unanimously agree that it is appropriate, and only then if the plan administrator finds that the alternative method will result in the distribution of ERISA documents which is at least as comprehensive as would result if the plan itself were solely responsible for the distribution. Also, since this would be an alternative method, multiemployer plans could continue to use their present distribution methods consistent with the Labor Department's regulations (including distribution methods that involve the cooperation of employers on a less structured basis than is contemplated by section 3212). Finally, to the extent that the proposed alternative method might be difficult for some contributing employers to satisfy (e.g., in the construction industry), we believe the provision can be modified to deal with such situations.

In summary, the alternative distribution method that would be made available by the enactment of section 3212 can only be beneficial to multiemployer plans and the other affected parties because -

(1) ERISA-required documents will reach the same number or more persons than under present law and regulations.

(2) Millions of dollars of administrative costs will be saved and can be used to pay for retirement benefits.

(3) The risk that a plan (and its trustees) may be found to be in violation of the disclosure rules of ERISA, notwithstanding diligent efforts to comply with the law, will be minimized or eliminated.

We believe that section 3212 properly has a place in any legislation that is designed to simplify and improve ERISA.

2. Publication of Summary Annual Report (Section 3207)

Under this section of the bill, the summary annual report would be posted at employees' principal work sites instead of being distributed to each employee by mail or other currently permissible methods. Posting would have to take place within 210 days (roughly 7 months) after the end of the plan year.

In the WCT Plan's view, the current value to participants of the summary annual report -- a document which contains relatively little useful information which, itself, may be difficult for participants to understand -- is highly questionable. On the other hand, it is clear that the preparation and distribution of this report is a costly and time-consuming job -- nearly $150,000 per year for the WCT Plan. Accordingly, the WCT Plan believes that the summary annual report requirement should be eliminated altogether. In this way, interested participants would still have the right to obtain detailed financial information from their plans on request while plans generally could reduce their administrative costs.

If, however, this provision of the bill is generally retained by the Subcommittee, we recommend that it be revised to reflect current Labor Department regulations which provide for the distribution of summary annual reports no later than nine months after the close of the plan year. 29 C.F.R. §2520.104b-10(b). The additional two months beyond the statutory annual report filing deadline which the Department has provided (i) recognizes that the financial and other information required by the annual report filing is frequently not compiled until shortly before that filing is made, and (ii) allows plans a reasonable amount of extra time to prepare, print and distribute the summary version of that filing. Any legislation relating to the summary annual report should recognize these practicalities of plan administration. Also, any change that the Subcommittee may make in the summary annual report requirement should not limit the ability of plans to furnish the report by methods other than posting. (In this regard, section 3207 contemplates alternatives to posting, but such alternatives apparently would have to be provided in new regulations which might not allow plans the same alternatives as current regulations.)

The WCT Plan would offer the Subcommittee an additional suggestion for simplifying plan administration under ERISA, consistent with the above recommendation that the summary annual report distribution deadline be preserved at nine months after the close of the plan year. Specifically, we recommend that the Subcommittee provide a two-month extension of the current deadline for furnishing participants with a summary of material modifications for the plan year (ERISA sec. 104(b)(1)(B)). In this way, both the summary annual report and the summary of material plan modifications could be distributed to participants in a single mailing no later than nine months after the end of the plan year. Such a change would benefit plans (by simplifying administration and, perhaps, lowering postage costs), and the two-month delay would not have any adverse effect on participants generally.

3. Simplification of Notice to Interested Parties (Section 3208)

This section of the bill is apparently intended to simplify the timing and publication aspects of the "notice to interested parties" requirement which must be satisfied when a plan applies for an advance determination letter from the Internal Revenue Service.

The WCT Plan has long been of the view that this requirement of ERISA, while probably well-intentioned, could easily be eliminated without diminishing participant protections in any real sense. Indeed, this notice requirement has clearly served to increase the administrative burden and costs of applying for IRS determination letters -- but, contrary to its apparent purposes, it has not, in our experience, generated any significant employee participation in the IRS determination letter process. For example, we understand that no WCT Plan participant filed a comment with the IRS in connection with a recently-filed application for determination letter. We are confident that any reasonable cost-benefit analysis of this particular "notice" requirement would support the conclusion that the elimination of this requirement would benefit plans and participants generally. We urge the Subcommittee to consider doing so.

If the "notice to interested parties" requirement is retained, however, we believe that any legislation in this area should allow multiemployer plans to continue to provide the notice in accordance with current Treasury regulations. Treas. Reg. §1.7476-2(c). These regulations permit collectively-bargained plans to post the notice, e.g., at local union meeting places, instead of requiring posting at every principal worksite of employees covered by the plan. Moreover, the current IRS requirements with respect to the time for posting are clearly appropriate, and are more reasonable than the 60-day advance notice requirement of the bill. Accordingly, while section 3208 is intended to simplify the IRS notice process generally, we believe it would merely complicate that process for multiemployer plans, and moreover, that it would do so for no useful purpose.

4. Disclosure of Status under Pension Plans (Section 3209)

The WCT Plan supports this provision of the bill which would consolidate several largely duplicative provisions of present law (sections 105 and 209), and would eliminate the need for plans to automatically notify certain non-vested employees of their accrued benefits. This provision properly recognizes that the distribution of benefit status reports to non-vested participants imposes unnecessary additional costs on plans.

There is one way that the Subcommittee could further improve and simplify this disclosure requirement for multiemployer plans. Specifically, we recommend that section 3209 be revised to require a multiemployer plan to automatically provide a report of deferred vested benefits no earlier than the time required by comparable Treasury Regulations under section 6057 of the Internal Revenue Code. In this regard, such Treasury Department regulations currently provide that multiemployer plans do not have to list separated vested participants on the Schedule SSA (part of the Form 5500) filed with IRS until the plan determines that a participant has had two consecutive one-year breaks as defined by the plan. Treas. Reg. §301.6057-1(b)(2). This regulation recognizes that, in the context of the highly-mobile work force that characterizes multiemployer plans, a single one-year break in service frequently signifies only a temporary hiatus in covered employment rather than a "separation from service." In these circumstances, the listing of a person based on a single one-year break in service would impose unnecessary costs on plans and, in some cases, could serve to confuse, rather than [illegible], participants who have left covered employment for relatively short periods of time.

In summary, there is no legitimate reason why multiemployer plans should have to comply with comparable benefit status report requirements at different times for Department of Labor and IRS purposes. Consistent with the purposes of the bill, we recommend that proposed section 105(b)(1) (contained in sec. 3209) be improved further by adding the following sentence at the end of that section:

> "In any case in which more than one employer adopts a plan, the administrator shall not be required to issue a report before the time for filing information relating to the participant's deferred vested retirement benefits prescribed by Treasury Regulation Section 301.6057-1(b)(2)."

III. PARTICIPATION AND VESTING PROVISIONS

1. Application of Benefit Accrual Rules in Cases of Delinquent Contributions to Multiemployer Plans (Secs. 3308 and 4308)

The WCT Plan strongly supports this provision of the bill which would clarify the application of ERISA's accrued benefit requirements in situations where an employer has failed to make the required contributions to a multiemployer plan in accordance with his obligation under a collective bargaining agreement.

In our view, this provision represents a reasonable and balanced solution to the serious problems which the Government's interpretation of ERISA -- an interpretation that requires the continued accrual of benefits regardless of whether the employer ever makes the contributions that the plan needs to support the payment of benefits -- threatens to create for multiemployer plans. Other witnesses have urged the Subcommittee to extend the application of this provision to multiemployer defined contribution plans, and the WCT Plan recognizes the merits of such an extension. Moreover, the WCT Plan recommends that -- in order to prevent the undue disruption to plans that would result if the Government's restrictive interpretation of ERISA applies to plan years preceding the enactment of the bill -- this clarification of ERISA should be made effective as of the original effective date of ERISA's benefit accrual requirements.

Section 3308 of the bill would make it clear that, consistent with the longstanding common practice of multiemployer plans, the contributing employers to the plan (and their employees) are not required to subsidize the funding of benefits for those employees whose employers have not satisfied their contribution obligations to the plan. As explained by Congressman Erlenborn (upon the introduction of H.R. 4330, the House counterpart of S.1541):

> Currently [multiemployer] plans are faced with the choice of either "kicking out" long delinquent employers or curtailing the benefits of employees of a delinquent employer. Removal by a plan of a delinquent employer is an unsatisfactory solution since it involves lengthy renegotiations, inordinate subsidies and expenses, and the harsh treatment of employees who incur service breaks for purposes of both vesting and benefit accrual. 127 Cong. Rec. H 5424 (July 30, 1981, daily ed.)(emphasis added).

By minimizing or eliminating the need for plans to expel delinquent employers, this provision of the bill is likely to result in greater benefits for participants in multiemployer plans. Moreoever, its enactment would help strengthen the funding of multiemployer plans by providing a reasonable mechanism for a plan to avoid accumulating further unfunded liabilities due to bankruptcies or other financial troubles affecting certain employers in the plan.

Significantly, the bill would allow multiemployer plans to suspend accrued benefits during periods of employer delinquencies only if several safeguards -- intended to protect plan participants -- were satisfied.

(1) The bill requires a plan to promptly notify the local union that represents the employees of the delinquent employer of the fact of the delinquency, and that benefits will not accrue until the required contributions are made. In this way, local unions may take appropriate steps toward payment by the employer so that the employees will accrue all benefits to which they are entitled. This result, of course, contrasts significantly with the Government's interpretation of ERISA under which delinquent employers actually would have less of an incentive to make their pension contributions since their employees stand to earn benefits whether or not the delinquency is paid off.

(2) Even though the fiduciary standards of ERISA independently require multiemployer plans to take prudent and reasonable steps to collect delinquent employer contributions, a plan could rely on this provision of the bill only if it "has adapted written procedures for the making of diligent and reasonable efforts for the collection of delinquent employer contributions and . . . has made appropriate efforts under the circumstances to collect the delinquent employer contributions". Accordingly, the enactment of this provision would not have the effect of discouraging plans from making efforts to collect the money that would entitle employees to their accrued benefits; if anything, this provision will further encourage the collection of employer delinquencies by multiemployer plan trustees (and the assistance of local unions).

(3) The bill expressly requires plans to restore accrued benefits to the extent that the employer delinquency has been collected.

In short, we believe that section 3308 clarifies the applicability of ERISA's benefit accrual requirements to periods of employer delinquency in the way that is most consistent with the interests of all of the affected parties: the plans, the contributing employers and the plan participants. Moreover, there is no strong reason why this reasonable solution to the problem should not be made effective from ERISA's inception. Indeed, in view of the existence of some uncertainty in this area, it appears that many plans have continued to apply their longstanding provision under which benefits do not accrue during periods of employer delinquency. In these circumstances, the application of a different rule for the past would merely require plans to reopen -- at very great expense and effort -- thousands of closed benefit claims in order to determine whether some additional benefit should be credited on account of past delinquent amounts. Moreover, many multiemployer plans will be faced with an unfair situation where -- for long periods of time -- they had no effective mechanism in place for protecting the contributing employers and plan participants from potentially substantial increases in unfunded liabilities due to bankruptcies, etc.

We believe that plans and their participants would be better served if plans could apply their longstanding practice in this area, without interruption, for all ERISA plan years. Accordingly, we strongly urge the Subcommittee to make the clarification of ERISA contained in section 3308 applicable beginning with the effective date of ERISA's benefit accrual standards.

2. Alimony and Support Payments (Sections 3310, 3605, and 4310)

Since its enactment in 1974, probably the most frequently litigated issue under ERISA has been whether the anti-assignment of benefits rule (section 206(d)) and/or the preemption of state law provision of ERISA (sec. 514) prevent former spouses of employees (and their dependents) from enforcing family support orders and similar claims against private pension benefits. The language of ERISA could easily have been read to put pension benefits beyond the reach of the former spouses and dependents of the employees who earned the benefits. However, the natural inclination of most courts has been to allow these family law rights to be enforced against pension plans. At the same time, the involvement of pension plans and their funding agents in employees' family law disputes has steadily increased to the point where plans have experienced substantial increases in administrative and legal expenses attendant to these disputes.

Section 3310 and related provisions of the bill address the serious problems that have arisen in this area in the form of provisions that reflect two worthwhile objectives:

(1) to protect, and allow enforcement of, the legitimate rights of spouses and dependents of participants against private pension plans; and

(2) to establish specific standards -- intended to minimize the costs and administrative burdens on plans -- governing the enforceability of family law orders and community property settlements.

The WCT Plan strongly supports the enactment of comprehensive and uniform Federal legislation substantially along the lines of section 3310. In this regard, some of the provisions of this section might be improved from a technical standpoint and we would be pleased to work with the Subcommittee and its staff on such improvements. (For example, we believe it is important that the bill make it clear that the fact that a former spouse may have a right to a participant's pension benefits does not make such spouse a "participant" for ERISA purposes.) Nevertheless, unlike other proposed legislation on this subject,[*] section 3310 does address most of the major problems that plans have faced in this area in a reasonable and workable manner. Specifically, the major problems that section 3310 addresses include the following.

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[*] See e.g. section 103 of S.888 (April 7, 1981).

(1) The involvement of pension plans in family law litigation has increased at an alarming rate. State courts, legislatures and attorneys for nonemployee spouses have become very sophisticated and aggressive in recognizing and enforcing marital property rights of spouses in pension benefits, and in collecting family support claims from such benefits. As a result, since ERISA was enacted (and largely since early 1977), the WCT Plan has been made a party to approximately 1,000 dissolution of marriage proceedings in the state of California alone (where there are specific statutory procedures for joining pension plans in divorce proceedings). In many cases, the legal fees incurred in these proceedings are a complete waste of resources since the employee may never even vest in the benefits that were anticipated at the time of the divorce. Section 3310 (proposed paragraphs (2)(C)-(E)) would minimize such wastes of pension plan resources.

(2) Family law orders and community property settlements frequently have been in conflict with the terms of the plan relating to the time when benefit payments may begin or the form of the benefit payments. This problem has involved plans in costly and administratively burdensome disputes and litigation. Section 3310 (proposed paragraph (2)(B)) should minimize the extent to which these conflicts arise.

(3) Family law orders and community property settlements are frequently executed many years before benefit payments begin, or even before the employee's entitlement to benefits is determined. Again, litigation and disputes may result over the proper split of the pension payment (between the employee and the former spouse) when benefits do commence. Section 3310 (proposed paragraph (2)(B)) should minimize such disputes.

(4) Because there is usually a lapse of years between the entry of the order or settlement and the time when pension benefits commence, neither the plan nor the employee may know where the former spouse is living when benefits do begin and a check is supposed to be sent to him or her. Indeed, we recently learned of a situation where a former spouse -- who could not be located when benefits were scheduled to commence -- appeared several years later to claim her share of past and future payments from the plan. Section 3310 (proposed paragraphs (2)(B) and (D)) should enable plans to locate former spouses in a timely manner and should minimize the risk that a plan may have to make the same payment twice.

In summary, S.1541 provides reasonable and necessary solutions to the host of difficult and costly problems that plans have experienced as unwilling parties to their participants' marital disputes. The enactment of legislation along these lines would benefit plans by reducing their legal and administrative costs and by generally making it easier for plans to operate; it would also benefit former spouses and dependents by clarifying their rights to employee pension benefits under ERISA.

3. Seasonal Establishments (Sections 3307 and 4307)

Section 3307 proposes a series of definitions and concepts in an effort to provide rules governing the eligibility, vesting and accrual standards that should apply under plans that primarily cover seasonal workers. As exemplified by the long absence of any Labor Department or Treasury Regulations in this area, this subject is a particularly complex one.

While not endorsing all of the definitions, etc., in section 3307, the WCT Plan does want to note its strong support for the basic principle that is incorporated in that section. Specifically, the WCT Plan supports the principle of the bill that special rules for seasonal workers should only be imposed on a plan "in which a majority of the employee plan participants are seasonal employees". Clearly, the application of any special rules to a "non-seasonal plan" could only have the undesirable effects of significantly increasing the funding and administrative costs of the plan for all of the plan's contributing employers and participating employees. Moreover, in order to determine whether the special rules were applicable, a plan such as the WCT Plan would have to have costly and burdensome procedures for regularly reviewing the status of the plan, the thousands of business locations at which its plan participants are employed, etc. Section 3310 reasonably recognizes that the costs and burdens that any such requirements would impose on non-seasonal plans would be greatly disproportionate to the marginal improvements they may provide to the relatively small seasonal segments of such plans.

4. Suspension of Benefits Because of Reemployment (Sections 3302 and 4302)

The WCT Plan generally endorses the changes that the bill proposes to make in the rules governing the suspension of benefits on account of a person's reemployment (particularly the provision that would allow a plan to suspend benefits, for up to 12 months, in addition to the period during which the participant was actually reemployed). We believe, however, that additional changes are necessary if multiemployer plans are to be able to apply and administer their benefit suspension rules in a reasonable and cost-effective manner. In this regard, one change that would substantially facilitate the application of these rules would be to supplement "the same industry, same trade or craft, and the same geographic area covered by the plan" standard of section 203(a)(3)(B)(ii) of ERISA with an alternative standard under which a plan could take into account any employment with respect to which an employer is required to make contributions to the plan.

Among the many limitations which the Department of Labor has placed, by regulation, on the suspension of benefit provisions of section 203(a)(3) of ERISA, perhaps the most troublesome one is the "facts and circumstances test" which plans are supposed to apply in order to determine whether a participant has been reemployed "in a trade or craft in which the employee was employed at any time under the plan." Prop. Reg. §2530.203-3(c)(2)(ii), 46 Fed. Reg. at 8905 (Jan. 27, 1981). This "facts and circumstances test" would be extremely burdensome for multiemployer plans to administer. In effect, once a plan has determined that a retiree has been reemployed -- a fact which itself is sometimes difficult for plan personnel to establish -- the Department of Labor would require a plan to make an individual factual determination whether the work being performed is the same type of work which the employee performed under the plan at some point in time, possibly 10 or 20 years earlier, before he began to receive benefits.

A single multiemployer plan frequently covers many different types of employment each of which may involve a separate "trade" or "craft". Indeed, it is clear that the WCT Plan covers employees who work in hundreds of different jobs. In some cases, these different jobs may be part of the same "trade" or "craft" while, in other cases, the jobs may be "similar" but perhaps not the "same". In view of such uncertainties, there are numerous cases where the determinations required by the "same trade or craft" test will be extremely difficult to make. Plans simply do not maintain records that provide this type of historic information. Indeed, plans might have to hire investigators solely to make the factual determinations that would be required by the Department's regulations. Obviously, there will be a great many cases where the costs and burdens attendant to such efforts will be substantially disproportionate to the value of the benefits that would be suspended.

The WCT Plan believes there is reasonable alternative to requiring multiemployer plans to make the difficult determinations described above merely so they can apply their benefit suspension rules. Specifically, we recommend that section 203(a)(3)(B)(ii) of ERISA be amended to add an alternative category of suspendible employment under which a multiemployer plan could provide for the suspension of benefits when a retiree has, in fact, been reemployed in any employment that is covered by the plan. Under this test, a plan could readily determine a person's reemployment since it would be entitled to receive employer contributions based on such reemployment. Such an alternative also would put multiemployer plans on a more comparable basis with single employer plans which, under present law, may suspend benefits on account of _any_ employment with an employer maintaining the plan that is paying the benefits.

Accordingly, we urge the Subcommittee to revise section 203(a)(3)(B)(ii) of ERISA (and section 411(a)(3)(B) of the Code) as follows:

> (ii) in the case of a multiemployer plan --
>
> (I) in the same industry, in the same trade or craft, and the same geographic area covered by the plan, as when such benefits commenced; or
>
> (II) in any employment covered by the plan with respect to which his employer is required to make contributions to the plan.

Another change which the Subcommittee should consider in this area is a revision of this provision of ERISA to clearly allow multiemployer plans to suspend benefits on account of reemployment in the geographic area covered by the plan if such reemployment is either in the same industry _or_ in the same trade or craft as when benefits commenced. Such a revision -- which was adopted by the Senate Labor Committee during the 96th Congress*/ -- would assist plans (or segments of a plan) where (i) an entire industry is covered by the plan but the participant's reemployment is or may be in a different trade or craft in that industry than the one in which he worked before receiving pension benefits, or (ii) the plan covers work in a particular trade or craft regardless of the particular industry in which the work was performed. The adoption of this change to present law (as interpreted by the Labor Department) would go a long way toward resolving the problems of multiemployer plans in this important area in a manner that is generally consistent with the original purposes of ERISA's benefit suspension rules.

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*/ §125, S.209, 96th Cong., 1st Sess. (as approved by the Senate Committee on Labor and Human Resources on May 16, 1979).

5. Changes in Actuarial Assumptions (Sections 3306 and 4306)

The WCT Plan generally supports this section of the bill which would limit the extent to which changes in the actuarial assumptions that a plan applies in determining the actuarial equivalence of optional benefit forms may be considered to involve reductions in accrued benefits. In this regard (and quite apart from whether the IRS position on this subject is a correct interpretation of ERISA) the IRS "solution" to this problem -- to require plans to "grandfather" previously accrued benefits that could be affected by the change -- may be very difficult to administer. Accordingly, the general effect of the IRS position is to restrict a plan from making reasonable changes in its actuarial assumptions as the plan's interest, mortality, etc., experience changes.

Our only suggestion concerning section 3306 is a technical one. Specifically, in order to be sure that most pension plans will be able to rely on this provision, we believe it should be made clear (in the amendment itself or in the legislative history) that the term "normal retirement benefit" generally refers to the plan's normal benefit form for an unmarried participant.*/ This clarification is important since, for most pension plans, the normal form of benefit for a married participant is the ERISA-required joint and survivor annuity even though the "normal retirement benefit" for most other plan purposes (including the determination of the actuarial equivalence of optional benefit forms under the plan) is a single life annuity.

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*/ This appears to be consistent with Treasury regulations generally defining the term "normal retirement benefit" for purposes of ERISA's vesting and benefit accrual standards. § 1.411(a)-7(c).

IV. ADMINISTRATION AND ENFORCEMENT PROVISIONS

Actions Relating to Delinquent Contributions (Section 3601)

This section of the bill contains two proposed changes which are of great importance to the efforts of multiemployer plans to ensure that employer contributions are paid in a timely manner.

First, this section would clarify that actions to collect delinquent employer contributions under section 515 of ERISA may be brought in state courts as well as Federal courts. This clarification will ensure that a multiemployer plan is not forced to commence a slower and more expensive proceeding in a Federal Court, rather than a quicker and less expensive proceeding in a state court, merely to be sure that the plan will be able to collect interest, liquidated damages and attorneys' fees (under section 502 (g)(2) of ERISA) if the plan is successful in the action.

Second, this section would provide a much-needed uniform statute of limitations governing delinquency suits under section 515. In the absence of such a provision, Federal courts have had to attempt to determine the applicable limitation period by reference to the appropriate statute of limitation, if any, under state law. This situation has added an unnecessary element of uncertainty and delay (as well as litigation costs) to Federal court collection actions by multiemployer plans. As a result, plans have sometimes had to compromise or forgive claims they otherwise could have collected in full.

In short, the changes that would be made by section 3601 of the bill are in the interests of multiemployer plans, their participants and their contributing employers. They should be enacted promptly.

* * * * * * *

The WCT Plan appreciates the opportunity to present its views on S.1541. We would be pleased to work with the Subcommittee and its staff on this worthwhile and important legislation.

Respectfully submitted,

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Senator **Nickles**. Our next panel consists of John Baker, who is executive director of the National Association of Pension Consultants & Administrators, and Frederick Hunt, executive director of the Society of Professional Benefit Administrators.

Mr. Baker?

STATEMENT OF JOHN W. BAKER, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF PENSION CONSULTANTS & ADMINISTRATORS, INC., ATLANTA, GA., AND FREDERICK D. HUNT, JR., EXECUTIVE DIRECTOR, SOCIETY OF PROFESSIONAL BENEFIT ADMINISTRATORS, WASHINGTON, D.C.

Mr. **Baker**. Thank you, Senator. My name is John W. Baker, and I represent the National Association of Pension Consultants & Administrators, and just one word, possibly, about that organization, so that you will know from where I am coming.

We represent approximately 200,000 small plans, those under 100 lives. We do not get into, generally, the large plan area. So I am really speaking to the small plan people which represents 200,000 small plans, as I understand it, represents about 40 percent of those small plans in the United States.

NAPCA strongly supports the provisions of title I of S. 1541, that would establish the Employee Benefit Administration. Congressmen John Erlenborn and Peter Peyser, serving in their capacity as a task force on pensions under the House Subcommittee on Labor/Management Relations, released on October 22, 1981, a General Accounting Office Study, entitled, "Better Management on Private Pension Plan Data Can Reduce Costs and improve ERISA Administration."

Congressmen Erlenborn and Peyser stated that the GAO Study underscores the inefficiency, waste, and duplication that continues to plague ERISA as a result of ERISA's multiagency administration. They also pointed out that each of ERISA's three administrative agencies, IRS, DOL, and PBGC, has pursued its own individual and distinct policies, leaving ERISA without a consistent policy of its own. Your bill, S. 1541, would correct these shortcomings by consolidating all of ERISA's functions, whose charter would be "To foster the orderly growth and maintenance of employee benefit plans," not "to collect taxes" or "to prosecute labor racketeers."

In the opinion of NAPCA, the recent GAO Study clearly emphasizes the need for a single agency to administer the Nation's private pension system. We believe that a three-member board with liaison officers from the IRS and DOL is clearly the best way to carry out the important plan benefit security role which ERISA mandated, but without the duplicative and confusing enforcement machinery which currently exists.

If you go back through our testimony over the last 5 years, Senator, you will see that we have really opposed the single agency because ERISA was trying to get straightened out, but after 7 years, we feel it is time to come up with a single agency.

In the preemption area, we strongly support the reaffirmation of the preemption rules in section 514 of ERISA, which is found in S. 1541. This provision clarifies the fact that the Federal securities laws and State insurance laws are inapplicable to employee benefit plans, but reserves to the States the right to decide marital disputes involving entitlement to plan benefits.

On the elapsed time method and certainty in vesting, we strongly support the clarification and codification of the elapsed time method for determining length of service of employees found in section 4311 and we especially applaud the provisions of the bill making 4/40 investing a safe harbor for small plans.

The major point which NAPCA wishes to make to this committee concerning vesting is the need for certainty in vesting for small plans. The small employer needs to know that he has a "safe harbor" which he may use and which some Internal Revenue agency may not come in and destroy in the absence of a showing by IRS of a pattern of actual abuse.

Provisions of the bill which eliminate the summary annual report are to be applauded, since this report has never been effective and can be far better handled by other means. Our studies show that approximately 2 percent of employees read it, and 98 percent do not.

On integration with Social Security, the intention of this proposal was to issue new integration regulations that are "less complex and more relevant to present circumstances." The effect, unfortunatley, is a provision that is extremely difficult to understand, would probably require amendment of approximately 95 percent of all small pension plans, and require all plans to recheck for nondiscrimination on an annual basis. This would increase administrative work and administrative expenses, and would probably require substantial regulations to aid understanding and compliance.

Finally, new plans are starting up at an increased rate, but such methods of integration as proposed would discourage the startup of new plans. We believe that there would also be plan terminations, as well as considerable unhappiness due to the increased administrative and legal expenses in trying to prove nondiscrimination on a yearly basis.

But specifically, the thing that causes us the most concern is the need to amend almost every small plan unless grandfathered. Worse yet, the need under the proposed method to recheck for nondiscrimination on an annual basis. We understand that the staff is reviewing this provision in view of the foregoing comments.

On the individual retirement payroll deduction plans, NAPCA particularly applauds title V of S. 1541, which requires that employers offer individual retirement payroll deduction plans. Section 5001-5004 effectively provides for a universal method by which employers may assist employees in developing the third leg of the three-legged stool for their ultimate retirement.

The concept of the three-legged stool in this country of retirement being based on primary social security, private retirement plans, and personal savings has faltered in large part due to the current bias against savings and in favor of more and more current consumption in the United States. Furthermore, contributions to qualified retirement plans adopted in the small business sector would appear not to effect adversely cost-push tendencies in our economy. Unlike the situation involving many large businesses, the realities of the small business marketplace generally do not permit a direct passthrough of such costs.

At the present time, most large businesses and large employee organizations have very comprehensive employee benefit plans, including in most cases, defined benefit plans. This is not the case with respect to small businesses, and the greatest opportunity for expansion of private pension coverage clearly lies in the small business and small employer plan sector. To the extent the private sector is encouraged to provide for adequate retirement, future demands on the Federal Government, social security in particular will be lessened. For this reason, it appears to us to be consistent with the fight against inflation and with the fight for retirement security for the private retirement sector to be permitted, and indeed encouraged, to expand and flourish. We believe S. 1541 is designed to accomplish that by combining limited deductibility of mandatory employee contributions.

This will bolster dramatically the personal savings leg of the three-legged stool, which will add immeasurably to the soundness of the American private pension system, thus rendering the mandatory university pension system, MUPS, recommended by the President's Commission on Pension Policy last year, totally unnecessary.

In conclusion, NAPCA strongly supports S. 1541 and H.R. 4330, the companion bill pending in the House, for the reasons just set forth above. Although ERISA was certainly well-intentioned, unfortunately, it has created many dislocations in the private pension industry, and after nearly 7 years of ERISA oversight, it is quite clear that the reporting and disclosure requirements of ERISA have created duplicative and complex reporting and disclosure requirements that have been especially troublesome with respect to small plans.

We support the provisions of S. 1541 which provide easier reporting for master trusts, provides for distribution of summary plan descriptions, does away with distribution to participants of the summary annual report, and provides for alternative methods of compliance with the reporting requirements as major steps toward elimination of duplicative and complex reporting and disclosure requirements.

Information required for administrative data base needs should be considered separately from information required for compliance. For example, comprehensive information as to plans could be acquired by statistically sound sampling. It is not necessary for every plan to report every detail every year. This is certainly the approach of S. 1541.

Finally, we believe that S. 1541 is an extremely desirable and much-needed piece of legislation for the simplication and reform of ERISA. We congratulate its sponsors on its fairness and completeness and urge its passage by the Congress at the earliest possible time.

[The prepared statement of Mr. Baker follows:]

Statement of John W. Baker, Executive Director of the National Association of Pension Consultants and Administrators, Inc., (NAPCA) Before the Labor Subcommittee of the Senate Committee on Labor and Human Resources with Respect to S.1541, Washington, D.C., November 9, 1981

Mr. Chairman, my name is John W. Baker. I am Executive Director of the National Association of Pension Consultants and Administrators, Inc. (NAPCA), located in Atlanta, Georgia.

As you may be aware, NAPCA was formed with the passage of ERISA to represent consultants and administrators who serve employee benefit plans and to provide for them a common voice for communicating with the Congress and the respective Agencies concerning the problems they face under ERISA. We now have over 300 members from virtually every state in the United States. Our members primarily represent small plans. Our average member will represent fifty or more plans, although some represent as few as ten, and others represent as many as 2,000.

My own profession is that of a consultant, administrator, and insurance broker to small employee benefit plans, primarily employee retirement plans. I am a chartered life underwriter and have been in the pension business for over twenty years. It is a pleasure to appear today to give you my reactions to Titles I through V of S.1541, realizing that later separate hearings will cover both Title VI relating to Amendments to the Plan

Termination Insurance for Single Employer Plans, and those provisions of Title III, Subtitle E, relating to Fiduciary Responsibility.

1. Employee Benefit Administration (EBA)

NAPCA strongly supports the provisions of Title I of S.1541 that would establish the Employee Benefit Administration (EBA). Congressmen John N. Erlenborn and Peter A. Peyser serving in their capacity as a Task Force on Pensions under the House Subcommittee on Labor Management Relations released on October 22, 1981 a General Accounting Office (GAO) Study, entitled "Better Management of Private Pension Plan Data Can Reduce Costs and Improve ERISA Administration".

Congressman Erlenborn stated that the GAO Study is the latest in a series of Congressional Oversight activities demonstrating the shortcomings of the Employee Retirement Income Security Act of 1974 (ERISA) and the need for early Congressional action on H.R. 4330, which is the counterpart in the House of your Bill, S.1541, which we are addressing today. Regarding the administration of ERISA's reporting requirements, the GAO Study found:

* Because of IRS and DOL mismanagement of Form 5500, Annual Report, the agencies have failed to obtain an accurate census of the Plans under their juris-

diction and, as a result, have been unable to adequately enforce the filing requirements of ERISA and have, in attempting to correct the situation, harrassed 175,000 plans unnecessarily.

* IRS failure to obtain missing Annual Report information covering more than 22% of all reports raises a question of whether all of the data is needed and whether the plan sponsors are being overburdened by the existing filing requirements.

* The Pension Benefit Guaranty Corporation (PBGC) clearly lacks adequate data controls to insure premiums are collected and may have lost as much as $3.7 million in premium income in 1977 alone.

* The need for filing Summary Plan Descriptions (SPD's) with DOL is certainly questionable, since DOL cannot readily locate 54% of the SPD's and must again request the SPD information from plans for 21% of the 950 requests made each year by the public for such information.

Congressmen Erlenborn and Peyser stated that the GAO Study underscores the inefficiency, waste, and duplication that continues to plaque ERISA as a result of ERISA's multi-agency administration. They also pointed out that each of ERISA's three administrative agencies, IRS, DOL, and PBGC, has pursued its own individual and distinct policies, leaving ERISA without a consistent policy of its own. Your Bill, S.1541, would correct these shortcomings by consolidating all of ERISA's functions under the Employee Benefit Administration (EBA), whose charter would be "To foster the orderly growth and maintenance of employee benefit plans", not "to collect taxes" or "to prosecute labor racketeers".

In the opinion of NAPCA, the recent GAO Study clearly emphasizes the need for a single agency to administer the nation's private pension system. We believe that a three-member Board with Liaison Officers from the Internal Revenue Service and the Department of Labor is clearly the best way to carry out the important plan benefit security role which ERISA mandated, but without the duplicative and confusing enforcement machinery which currently exists.

2. Preemption

We strongly support the reaffirmation of the Preemption Rules in Section 514 of ERISA, which is found in S.1541. This provision clarifies the fact that the Federal Securities laws and state insurance laws are inapplicable to employee benefit plans, but reserves to the States the right to decide marital disputes involving entitlement to plan benefits.

3. Elapsed Time Method and Certainty in Vesting

We strongly support the clarification and codification of the "Elapsed Time Method" for determining length of service of employees found in Section 4311 of S.1541, and we especially applaud the provision of the Bill making "4/40 vesting" a safe harbor for small plans. The major point which NAPCA wishes to make to this Committee concerning vesting is the need for certainty in vesting for small plans. The small employer needs to know that he has a "safe harbor" which he may use and which some Internal Revenue Agent may not come in and destroy in the absence of a showing by IRS of a pattern of actual abuse.

4. Summary Annual Report

Provisions of the Bill which eliminate the Summary Annual Report are to be applauded, since this Report has never been effective and can be far better handled by posting.

5. Integration with Social Security

The intention of this proposal was to issue new integration regulations that are "less complex and more relevant to present circumstances." The effect, unfortunately, is a provision that is extremely difficult to understand, would probably require amendment of approximately 95% of all small pension plans, and require all plans to re-check for non-discrimination on an annual basis. This would increase administrative work and administrative expenses, and would probably require substantial regulations to aid understanding and compliance.

Such a provision would certainly discourage the start-up of new plans, which is finally happening at an increased rate now. We believe that there would also be plan terminations, as well as considerable unhappiness due to the increased administrative and legal expenses in trying to prove non-discrimination on a yearly basis.

While the current social security integration rules have been in effect for 10 years, we are not sure that they are outdated. One of their merits is that minimal understanding is needed to know how to properly use the rules. What's more important, barring certain types of plan amendments, a plan that is initiated with an integration percentage computed correctly need never be changed. The plan can never become disqualified because of extraneous factors.

While non-discrimination is an objective that we can accept without reservation, social security with its indexing does a creditable job as far as it goes, especially at the lower income levels. "Excess plans" are simply an extension of retirement benefits to uncovered portions of compensation, and other integrated plans merely carry out the principle of equity in total retirement benefits. Not all companies can afford a specific level of total benefits, another unfair feature of the proposed provision in S.1541.

But, specifically, the thing that causes us the most concern is the need to amend almost every small plan (unless they are grandfathered) and, worse yet, the need under the proposed method in S.1541 to re-check for non-discrimination on an annual basis. We understand that the Staff is reviewing this provision in view of the foregoing comments.

6. Qualified Retirement Savings Contributions

We strongly support the provisions of Title II of S.1541, which would allow in addition to the current deductible voluntary contributions, certain mandatory employee contributions to be deductible as well, subject, however, to the special offsets provided in S.1541 for Qualified Retirement Savings Contributions. In addition, Section 2004 of the Bill adds a new section to the Internal Revenue Code, Section 414(n), which provides that any amount of a Qualified Retirement Savings Contribution shall be treated as an employer contribution to the extent that such amount is allowed as a deduction under Section 221 of the Code. This provides an exclusion for these contributions from the estate of the employee-participant who makes them.

7. Individual Retirement Payroll Deduction Plans

NAPCA particularly applauds Title V of S.1541, which requires that employers offer Individual Retirement Payroll

Deduction Plans. Section 5001-5004 effectively provides for a "universal" method by which employers may assist employees in developing the third leg of the "three-legged stool" for their ultimate retirement.

The concept of the "three-legged stool" in this country of retirement being based on primary Social Security, private retirement plans, and personal savings has faltered in large part due to the current bias against savings and in favor of more and more current consumption in the United States. See "The U.S. Bias Against Savings Leads to High Inflation, Weak Dollar, Slow Growth, Declining Productivity", Business Week, 90 (December 11, 1978). Furthermore, contributions to qualified retirement plans adopted in the small business sector would appear not to effect adversely cost-push tendencies in our economy. Unlike the situation involving many large businesses, the realities of the small business marketplace generally do not permit a direct pass-through of such costs.

At the present time, most large businesses and large employee organizations have very comprehensive employee benefit plans, including in most cases, defined benefit pension plans. This is not the case with respect to small businesses, and the greatest opportunity for expansion of private pension coverage clearly lies in the small business and small employer plan sector. To the extent the private sector is encouraged to provide for adequate retirement, future demands on the

Federal Government - Social Security in particular - will be lessened. For this reason, it appears to us to be consistent with the fight against inflation - and with the fight for retirement security - for the private retirement sector to be permitted, and indeed encouraged, to expand and flourish. We believe S.1541 is designed to accomplish that by combining limited deductibility of mandatory employee contributions with a means whereby those contributions may be systematically funnelled into the right investment objectives through the new, required Individual Retirement Payroll Deduction Plan.

This will bolster dramatically the personal savings leg of the "three-legged stool", which will add immeasurably to the soundness of the American private pension system, thus rendering the Mandatory Universal Pension System ("MUPS") recommended by PCPP last year unnecessary.

8. Conclusion

NAPCA strongly supports S.1541 and H.R. 4330, the companion bill pending in the House of Representatives, for the reasons set forth above. Although ERISA was certainly well-intentioned, unfortunately, it has created many dislocations in the private pension industry, and after nearly 7 years of ERISA Oversight experience, it is quite clear that the reporting and disclosure requirements of ERISA have created duplicative and complex reporting and disclosure requirements that have been especially troublesome with respect to small plans.

We support the provisions of S.1541, which provides easier reporting for Master Trusts, provides for distribution of Summary Plan Descriptions (SPD's) every 10th year, provides for publication of the Summary Annual Report (SAR) through posting, and provides for alternative methods of compliance with the reporting requirements as major steps towards elimination of duplicative and complex reporting and disclosure requirements.

Access to plan records and information is a necessary corollary to enforcement of rights of participants and beneficiaries. However, reporting and disclosure should be viewed as a means to an end, and not the end itself. It is NAPCA's view that the basic objectives can be accomplished more simply and less expensively by requiring employers to keep detailed records for audit by the Employee Benefit Administration envisioned in S.1541 and open to review by participants and beneficiaries, but to eliminate the existing ERISA paperwork burden wherever possible.

Information required for administrative data base needs should be considered separately from information required for compliance. For example, comprehensive information as to plans could be acquired by statistically sound sampling. It is not necessary for every plan to report every detail every year. This is certainly the approach in S.1541.

Finally, we believe that S.1541 is an extremely desirable and much-needed piece of legislation for the simplification and reform of ERISA. We congratulate its sponsors on its fairness and completeness and urge its passage by the Congress at the earliest possible date.

Respectfully submitted,

John W. Baker
Executive Director
National Association of Pension
Consultants and Administrators,
Inc. (NAPCA)

Senator NICKLES. Thank you, Mr Baker.

Next, Mr. Hunt?

Mr. HUNT. Mr. Chairman, my name is Fred Hunt, and I am executive director of the Society of Professional Benefit Administrators, better known as SPBA. We are genuinely delighted to support both the purpose and the legislative detail of S. 1541, and we urge rapid enactment.

SPBA is the national trade association of independent third party contract administrators of corporate and multiemployer employee benefit plans. It is estimated that nearly one-third of all workers in the United States are covered by plans administered by such firms. Thus, members of SPBA are in the front lines of providing business-like benefit administration while simultaneously attempting to comply with the vast outpouring of regulations, rulings and decisions which have been issued under the ERISA law.

Let me emphasize that our members—and I would suspect, members of the other organizations testifying here today—support the legislative purposes of ERISA, to establish standards that give reasonable assurance to pension plan participants. We were very impressed, I might say, and gratified, that you, in putting together this law, have such a clear understanding of the shortcomings of the original law and such perceptive remedies. This is very rare.

Senator NICKLES. Flattery will get you everywhere.

Mr. HUNT. It is true.

Title I would establish the Employee Benefit Administration, or EBA, as the single agency responsible for ERISA administration. We strongly support this. ERISA regulation and enforcement divided among the Department of Labor, IRS, the Treasury Department, the PBGC, and the Justice Department simply has not worked.

However, we have one important concern and word of caution about the proposed EBA. Would you suggest that the new EBA Director review carefully the level of effort and expertise of any present employees he may wish to transfer to the new Department from the existing agencies. There is the feeling among many pension practitioners that the current regulatory people are, or exacerbate the problems. Moving the problems would not remedy them.

Title III deserves and enjoys overwhelming acclaim by our members. They particularly appreciate the clarification of ERISA preemption of State laws, both with regard to ERISA's prohibitions against assignment and alienation, but especially with regard to State insurance laws which mandate that specific benefits be included in insured benefit plans.

With 50 State legislatures prescribing 50 sets of mandated benefits, it is an underwriting and administrative nightmare for a nationwide firm or a regional multiemployer benefit plan to offer a uniform plan of benefits for all participants.

Though many of our members specialize in the administration of self-insured plans, we are the first to say that avoidance of State-mandated benefits should not be the motivating reason for self-insuring.

The entire thrust of title III relating to prohibited transactions—which I understand will be discussed later, but if I may throw in a word or two—is in the right direction, in our opinion. Clarification of the prohibited transactions may remedy some of the problems noted with current regulatory personnel.

We strongly support this bill's substitution of the more workable standard that plan transactions with parties in interest be allowed, but meet tests involving adequate consideration, adequate security, and reasonable rates of interest consistent with fiduciary requirements.

We also commend the replacement of the current IRS 5 percent and 100 percent excise tax penalties with "discretionary" civil penalties.

In title IV, there are two sections which are critical as administrative considerations to our members and which are affected by two sets of proposed, but not yet final, Department of Labor regulations. We feel that it would save costly and futile compliance efforts for plans and embarassment for the Government, if these regulations could be postponed until S. 1541 is enacted. Both regulations have been dangling for 7 years, so we feel that a few more months certainly would not hurt.

The first proposed regulation deals with a pension plan administrator's responsibility to disclose accrued benefits to plan participants. We would support amending ERISA to require automatic disclosure only to vested employees. We feel it is both silly and impractical to insist upon notification to long-gone nonvested participants for whom the plan has no access to a current address, and then only to inform them that they have no vested benefits, anyway.

The second regulation deals with suspension of benefits for pensioners who are covered under multiemployer plans and who return to work. This proposed regulation has improved, but still contains some unworkable complications.

Please understand that this notation of the proposed regulations is not a blast at the Department of Labor. We believe that the 7-year hatching period for these regulations is evidence that the Department itself realizes the problems that the current ERISA law would force it to impose.

In title IV, we note with pleasure that amortization of pension past-service liability would be allowed over 5 years rather than the current 10-year limitation. That change is particularly important as it affects employer liability to fund vested benefits under proposed title VI. SPBA recognizes the wisdom in changing the insurable event under PBGC from plan termination to employer insolvency, and consequently supports legislation enabling early full funding of vested benefits.

It is obviously not our intention to try and list every one of the many beneficial changes contained in this legislation. It was obvious that you understood the problems and you found the remedies during the drafting. All we can say is that we have seldom seen—and we mean this very sincerely—such thoughtful care in spelling out not only the substantive changes, but also a great array of technical changes and clarifications which were so badly needed to make ERISA serve the laudable function that Congress originally intended.

The Society of Professional Benefit Administrators supports passage and offers its experience, expertise, and perspective if we can be of technical assistance to the committee or to your staff.

Senator NICKLES. Thank you very much, Mr. Hunt.

[The prepared statement of Mr. Hunt follows:]

Society of
Professional
Benefit
Administrators
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TESTIMONY
OF THE
SOCIETY OF PROFESSIONAL BENEFIT ADMINISTRATORS
TO THE
SUBCOMMITTEE ON LABOR
COMMITTEE ON LABOR AND HUMAN RESOURCES
UNITED STATES SENATE
IN SUPPORT OF S 1541
THE RETIREMENT INCOME INCENTIVES &
ADMINISTRATIVE SIMPLIFICATION ACT OF 1981
BY
FREDERICK D. HUNT, JR., EXECUTIVE DIRECTOR

Mr. Chairman, my name is Frederick D. Hunt, Jr., and I am Executive Director of the Society of Professional Benefit Administrators. We are genuinely delighted to support both the purpose and the legislative detail of S. 1541...and I might add, H.R. 4330. We urge rapid enactment in both houses.

SPBA is the national trade association of independent third party contract administrators of corporate and multi-employer employee benefit plans. It is estimated that nearly one-third of all workers in the United States are covered by plans administered by such firms. As such, members of SPBA are in the front lines of providing business-like benefit administration while simultaneously attempting to comply prudently with the vast outpouring of regulations, rulings, and decisions which have been issued under ERISA.

Let me emphasize that our members support the legislative purposes of ERISA to establish standards that give reasonable assurance to pension plan participants. We believe that employees should know that their benefit plans are adequately funded and are written so as to provide realistic vesting and benefit rules. Further, we agree that participants of all kinds of plans should have reasonable assurance that benefit contributions received and reserves held by pension plan trustees and administrators are handled prudently.

We are very impressed and gratified that the authors of this legislation have such a clear understanding of the short-comings of the original ERISA law and have such perceptive remedies.

Title I, would establish the EMPLOYEE BENEFIT ADMINISTRATION (EBA) as a single agency responsible for the administration of ERISA. We strongly support this. ERISA regulation and enforcement divided among the Department of Labor, IRS, the Treasury Department, the PBGC and the Justice Department simply has not worked.

Charles B. Jackson, President — American Benefit Plan Administrators, Los Angeles, California
Glen Slaughter, Vice President — Glen Slaughter & Associates, Oakland, California
W. Richard Perkins, Secretary — Executive & Employee Benefit Plans, Inc. Atlanta, Georgia
James M. Dawson, Treasurer — James M. Dawson, Associates Manchester, New Hampshire
Steven L. Sherman — United Administrators, Inc. Seattle, Washington
R.B. Swartie — Swartie-Lapp, Inc. Minneapolis, Minnesota
Russell C. Taylor — Galbraith & Green, Inc. Wheat Ridge, Colorado
John Timmer — Employee Services, Inc. Sioux Falls, South Dakota
Richard H. Biles — Biles & Cook Administrators, Inc. Los Angeles, California
Frederick D. Hunt, Jr. — Executive Director

However, we have one important concern and word of caution about the proposed EBA. The new law would direct the President to transfer "...officers and employees...of the Department of Labor and the Department of Treasury--including the Internal Revenue Service--as may be necessary...in order that the present level of effort and expertise not be diminished..." We would suggest that the new EBA Director review carefully the level of effort and expertise of any present employees he may wish to transfer to the new Department from the existing offices. The apparent lack of effectiveness of present agency personnel in dealing with nationally publicized examples of fiduciary abuse in managing benefit plans has become obvious to many of our members. At the same time, many pension practitioners have been equally concerned with the apparent tunnel vision and petty interests of some personnel conducting Department of Labor routine audits and investigations. Lack of applicable knowledge of how the pension system works and/or unnecessarily time-consuming searches for inconsequential trivia on the part of some Department of Labor personnel seem to be leading some pension practioners to hold ERISA in contempt...not respect. This seems to be a touchy... but industry-wide concern.

In discussing the companion bill to S 1541, Representative Erlenborn told the House of Representatives, "...this administrative design has not worked. ERISA has been repeatedly included in a list of government programs known for excessive bureaucracy. It earned this reputation through well-documented examples of duplication and waste, confusion and delay, complexity and lack of inter- and intra-agency cooperation..." SPBA concurs wholeheartedly with the Representative. Moving problems will not remedy them.

Title III, ERISA CORRECTION, CLARIFICATION AND SIMPLIFICATION deserves and enjoys overwhelming acclaim by our members. They particularly appreciate the clarification of ERISA pre-emption of state laws both with regard to ERISA's prohibitions against assignment and alienation...but especially with regard to state insurance laws which mandate that specific benefits be included in insured benefit plans.

With 50 state legislatures prescribing 50 sets of mandated benefits, it is an underwriting and administrative nightmare for a nationwide firm or a regional multi-employer benefit plan to offer a uniform plan of benefits for all participants. Let me be candid and say that though many of our members specialize in the administration of "self-insured" plans, we are the first to say that avoidance of state-mandated benefits should not be the motivating reason for self-insuring.

The entire thrust of Title III relating to prohibited transactions is in the right direction in our opinion. Clarification of prohibited transactions may remedy some of the problems noted with current regulatory personnel.

Again, we agree with Representative Erlenborn's comment, "...the breadth of the prohibited group and the difficulty in identifying all parties-in-interest make it problematical whether any fiduciary in an employee benefit plan can really be certain he is not participating in a transaction in violation of section 406(a)...", and further that, "...few if any past witnesses have expressed any degree of satisfaction in the practical effects of the exemption process."

We strongly support this bill's substitution of the more workable standard that plan transactions with parties-in-interest be allowed, but meet tests involving adequate consideration, adequate security, and reasonable rates of interest consistent with fiduciary requirements. We also commend the replacement of the current IRS 5% and 100% excise tax penalties with "discretionary" 5% and 100% civil penalties. We believe that these changes in definition and enforcement of prohibited transactions will be at least quietly welcomed by the responsible government agencies who have been in the unenviable position of being damned for overly eager enforcement...or equally damned if they didn't.

In Title IV, there are two sections which are critical as administrative considerations to our members and which are affected by two sets of proposed, but not yet final, Department of Labor regulations. It would save costly and futile compliance efforts for plans and embarassment for the government if these regulations covering ERISA Section 105(a) could be postponed until S. 1541 is enacted. Both have been dangling for 7 years. A few more months wouldn't hurt.

The first proposed regulation deals with a pension plan administrator's responsibility to disclose accrued benefits to plan participants. We would support amending ERISA to require automatic disclosure only to vested employees who suffer a one year break in service. It is both silly and impractical to insist upon notification to long-gone non-vested participants for whom the plan has no access to a current address...and then only to inform them that they have no vested benefits, anyway.

The second regulation, deals with suspension of benefits for pensioners who are covered under multi-employer plans, and who return to work. This proposed regulation, thanks to public input, has improved but still contains some unworkable complications... especially a provision that recovery of overpayments cannot be recovered in full before resumption of monthly payments, but must be limited to 25% of the monthly payment over subsequent payment periods.

Please understand that this is not a criticism of the Department of Labor. We believe that the seven year hatching period for these regulations is evidence that the Department, itself, realizes the problems that the current ERISA law would force it to impose.

In Title IV INTERNAL REVENUE COST AMENDMENTS, we note with pleasure that amortization of pension past service liability would be allowed over five years rather than the current ten year limitation. That change is particularly important as it effects employer liability to fund vested benefits under proposed Title VI SINGLE EMPLOYER INSURANCE AMENDMENTS. SPBA recognizes the wisdom in changing the insurable event under PBGC from plan termination to employer insolvency, and consequently supports legislation enabling early full funding of vested benefits.

It is not our intention to list every one of the many beneficial changes contained in this legislation. Obviously you understood the problems and found the remedies during the drafting. All we can say is that we have seldom seen such thoughtful care in spelling out not only the substantive changes, but also a great array of technical changes and clarifications which were so badly needed to make ERISA serve the laudible function Congress intended. The Society of Professional Benefit Administrators supports passage and offers its experience, expertise, and perspective if we can be of technical assistance to the Committee or to your staff.

Thank you.

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Senator NICKLES. Mr. Baker, a couple of quick questions. You mentioned that you are associated with a lot of small plans, and you also touched on the social security integration question. How many of the small plans are actually integrated with social security? Do you have any idea?

Mr. BAKER. I do not know how many, but a good many of them are integrated.

Senator NICKLES. Do you have any idea percentage-wise?

Mr. BAKER. Well, wherever there are two plans in a company, one is always integrated, for the most part, and I would say that 25 to 30 percent of our plans have two plans in every corporation.

Senator NICKLES. A lot of plans that I am personally familiar with, I think, were originally integrated with social security but possibly froze on smaller integration levels.

Mr. BAKER. Yes.

Senator NICKLES. Has that happened often in integration-type plans, where they are initiated on the 4800, or whatever the steps were at that time, and then stayed frozen on those, or did they continue flexible with the social security changes?

Mr. BAKER. Most of them would stay frozen, primarily because it took another piece of paper to get approved by IRS to come unfrozen, and the small businessman does not like to get involved with the Government unless he has to, and so he just continued at the original level.

Senator NICKLES. That is interesting. I think I might advise staff and also research that we are going to have to do more homework on the integration question, particularly with the number of plans, where they are as far as their levels, where those breaks are, if it is at 4800, or if it is now up to $30,000—I think we are talking about a significant difference.

Mr. BAKER. If we could help you on that, Senator, we would be very happy to.

Senator NICKLES. I would appreciate that.

You mentioned that you would like to grandfather the smaller plans to where they would not have to comply with what, the changes that we are talking about in S. 1541?

Mr. BAKER. Well, that came under—perusing documents—I remember reading that, but now I cannot find where——

Senator NICKLES. Let me pass over to a couple of other questions, and then I will get back to you on that one.

The legislation as it stands right now would exempt plans with 35 or fewer participants from PBGC premiums. Do you agree with that, or not?

Mr. BAKER. Yes, I agree with that. I agree it probably should be higher than that, but there is compromise in everything, and 35 is probably a reasonable number. Most plans that we represent are under 35 lives. If they are under 100 lives, they are usually under 35.

Senator NICKLES. Well, let me not necessarily take the devil's advocate. I see both pluses and minuses to it. But those plans are also receiving the insurance benefits—in other words, their liabilities are guaranteed by PBGC. Shouldn't they also contribute to the costs for receiving those benefits?

Mr. **Baker**. Yes, but you have got to realize in a small plan, most of them are fully funded all the way through. There are very few small plans that are not fully funded. It is an oversight of the employer if they are, because for the most part in small plans, the employer is getting a fair share of the percentage himself, so he is going to want it fully funded.

Senator **Nickles**. You think that in smaller plans, the employer has probably a much greater percentage of the benefits in the plan individually, and he is going to, you think, take efforts to insure it. But you still have small companies that are going broke.

Mr. **Baker**. Yes, you do, and I agree that that happens. But also, the expense of that to a small employer is one of the reasons possibly why he might go broke.

The small plan area is so much different than the big one, where you have consultants and administrators coming in and talking on a yearly basis to the employees. The employer has the personnel department, whereas it does not have a personnel department in Detroit, and the guy is working in San Francisco. Small employers are much more on a 1-to-1 basis with their employees, they get the certificates, they read them over, have meetings, and so forth. So it is a much closer relationship. Therefore, things that might go wrong cannot go wrong nearly as easily in the small plan without the employee knowing it as they can in the big plan, where it is up in the sky somewhere.

Senator **Nickles**. What is the form that requires the premium payment? Is that EBS-1?

Mr. **Baker**. I am not the actuary.

Senator **Nickles**. PBGC-1, that requires the premium payment.

Mr. **Baker**. Yes, PBGC-1.

Senator **Nickles**. You have worked as an administrator. Have you filled out those forms for an employer or helped him?

Mr. **Baker**. Yes. I am really not the right one to ask that question of, Senator, because I am not the guy doing the actual work. I am the guy running the firm.

Senator **Nickles**. I will ask that question at a different time to a different person.

One additional question. You came out fairly strong for title V of the bill, that would require small employers to set up IRA's. I would be less than candid if I said I do not have some reservations about that section and am contemplating some changes in the markup. But you are fairly strong for it.

Mr. **Baker**. Yes.

Senator **Nickles**. But wearing the small business hat, the negatives of being compelled to do anything in a small business are very real.

Mr. **Baker**. It is a great argument within our organization. But as we looked at MUPS and some of the things that that might do and trying to keep the private sector still going within things like the mandatory contributions, we felt the compromise of that was much better than the Government putting in, just willy-nilly, anything they wanted.

Senator **Nickles**. So you see it as somewhat of an evil but much better than——

Mr. **Baker**. Than some of the things that have been proposed.

Senator NICKLES. OK, good.

Mr. Hunt, a couple of things. You mentioned that as a plan administrator, I guess somewhat from your comments on title I of the bill and your recommendation for the Employee Benefits Administration—what type of service have you had, let us say, from DOL and Treasury and PBGC, as far as help in making changes in implementation of plans? We heard the earlier panel mention 3 years and 4 years in trying to get some changes put through and exceptions made. What type of experience have you found?

Mr. HUNT. Well, as background, I have to plead ignorance. I am not an administrator myself. I am executive director of the association, so all I get are the bitches. I can, however, answer the question in the broad scope, without specific details. I think that Mr. Groom's experience is unfortunately, par for the course. We hear a lot of that. Some of the complaints that we have heard have been not so much on the specific, routine administrative problems as much as—well, for instance, the Congress in the last week heard an awful lot about crime rampant in pension plans and union plans, et cetera, et cetera, and the fact that the Government had not been on the ball there. And yet, I hear untold numbers of horror stories about the person who has the DOL auditor in there to worry about—in one case, it was a $1.65 phone call, where a trustee at a trustees' meeting had gotten the message at the hotel where they were meeting that his office had called, so he called back and charged it to his room, which was charged to the plan. Obviously, that is not that serious—but they spent days and days and took copies, and on and on. That is the type of example. In another case, a fellow up in the Northeast had gone for 6 years—and by the way, these audits were just routine; there was not anything wrong with the plan—and the auditor had spent, I believe it was 2 or 2½ years on the audit, which has yet to come up with any results. Lo and behold, the fellow got another letter saying, "This plan is going to be audited again." He called and said, "But you have not finished the last one." They said, "Well, you will have to call this number," and when he got the number, he thought, gee, it was similar to the original auditor's. Well, the two auditors are in the same room, their desks facing each other, and he was getting double audits, back to back. He has tried to call. He has tried to say, "Let us look at the commonsense of this." Our members have found that often—and I do not mean to be jumping on the auditors—that when you are clean somebody keeps, in effect, saying you are not. This is especially embarassing, if it is a client relationship, not a salaried relationship. Our members are responsible to their clients, and the trustees get letters from the auditors saying, "Well, there were some discrepancies." That was the description one auditor gave for plans which he probably said were the last he'd ever seen. Well, obviously, you begin to worry.

So these are the types of things we have found, that they just do not seem to have familiarity with the pension business or even the employee benefits business. In many cases, they thought the employees were paying for the pensions themselves, rather than the employers, which is the norm.

Senator **Nickles**. Would you elaborate a little further on the proposed regulation which you referenced, which would require the disclosure of accrued benefits to plan participants?

Mr. **Hunt**. Yes, unfortunately, I realized when I was coming up, that I do not have the regulations.

Senator **Nickles**. Is this a regulation that is open for suggestions?

Mr. **Hunt**. It has been proposed—there are two of them, and both of them have been proposed and proposed and proposed over and over again, over the years. This particular one, the nitty-gritty of which would be that you would have to keep track of where somebody was. Our people said, "But under the privacy laws, we cannot insist that a long-gone employee tell us where he is."

Senator **Nickles**. Well, in most cases, we are talking about a terminated employee.

Mr. **Hunt**. Yes, who is nonvested.

Senator **Nickles**. Who is nonvested. Now, that is a question, because you would always have track of a vested employee, I am assuming——

Mr. **Hunt**. Well, the person would literally have a vested interest in keeping you informed where he is. But a nonvested employee who has nothing—and a lot of people that we are talking about would be laborers of various kinds, be they plumbers or construction workers, and they may be in Washington State 1 month, in Oklahoma the next. with many employers. They move around. This is one of the problems with a lot of the regulations. They do not take into account that in a multiemployer plan, there is often no such thing as a continuous employer, as such. You may have 10 or 12 in a year.

Senator **Nickles**. The intent of the regulation, though, was to show the participants, or have the plan administrator show the participant what his accrued benefit is?

Mr. **Hunt**. Yes. It is fine for the vested, terminated employee; I do not think anyone argues with that. This was just a fluke that somebody had said for everyone. And I think part of the intent was probably that the employee might leave, thinking that he has some money vested and this was, in effect, to send it to say, "Hey, you do not have anything,". That would allow a challenge in a timely manner. I do not think we would have any problem with doing it once. I believe the regulations, if I am not mistaken, are saying you have to do it year after year after year.

Senator **Nickles**. Today, under defined benefit plan, it is not required that we show participants what their accrued benefit is?

Mr. **Hunt**. I am rapidly getting out of my depth.

Mr. **Baker**. They do not.

Senator **Nickles**. You do not. That is a very complicated assumption. If a person is 10 or 20 years to retirement on a defined benefit plan that would pay a certain percentage of final average services, it is a very complicated figure to show what your accrued benefit is to date, which has very little—well, I am not going to say little value—but it is a very complicated figure to come up with, that would change yearly.

Mr. **Baker**. It is a real actuary problem, right.

Could I get back 1 minute to the grandfathering?

Senator NICKLES. Yes.

Mr. BAKER. It was on the social security and the integration. And we are only saying that if you do not grandfather, that means that almost every plan in the United States probably will have to be amended, and probably will have to be looked at year in and year out, and we do not think the small employer is going to put up with that, and therefore, may cancel his plans, and new ones may not start up.

Senator NICKLES. Those plans with social security integration?

Mr. BAKER. Right.

Senator NICKLES. So you are saying that——

Mr. BAKER. If you grandfathered them, then they would not have to amend them; if you do not grandfather them, we will have to amend them, and that then makes another form to IRS, et cetera.

Senator NICKLES. Thank you, Mr. Baker and Mr. Hunt.

Our next guest is Edward Clarke, who is vice president of operations of the Turner Construction Co., representing Associated General Contractors of America.

Good morning, Mr. Clarke.

STATEMENT OF EDWARD P. CLARKE, VICE PRESIDENT OF OPERATIONS, TURNER CONSTRUCTION CO., NEW YORK, N.Y., REPRESENTING THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA, AND ACCOMPANIED BY DENNIS M. BRADSHAW AND DAN KENISE, AGC STAFF

Mr. CLARKE. Good morning, Senator. I am Edward Clarke, as you ssid, representing the Associated General Contractors of America, and with me today are Dennis Bradshaw and Dan Kenise, of the AGC staff.

Turner Construction Co. is involved in over 1.5 billion dollars' worth of building construction annually, throughout the United States. As a result, we are contributing to dozens of multiemployer plans, and in addition, maintain a single-employer plan for our nonrepresented staff.

Our statement summarizes the key points. We understand the full statement will be incorporated as part of the record.

AGC has a longstanding interest in pensions and ERISA. AGC's 8,500 general contractor members contribute to hundreds of multiemployer pension plans and also serve as trustees on many of these plans. Additionally, AGC's members maintain single-employer pension plans for their nonrepresented employees.

Generally, AGC supports the idea of improving ERISA, and most of the provisions of S. 1541. Although the concept of protecting employee retirement benefits is laudable, it has become increasingly clear that certain sections of the Employee Retirement Income Security Act of 1974 have created more problems than solutions. The present overlapping authority and duplicative efforts of the Departments of Labor and Treasury, and the Pension Benefit Guaranty Corporation, have resulted in unnecessary and burdensome reporting and disclosure requirements, overregulation, and additional bureaucratic redtape. This has increased administrative costs for the employee benefit plans dramatically. These increased costs have taken on even greater significance in light of the 1980 multiemployer amendments to ERISA.

AGC supports centralized administration through the establishment of the Employee Benefit Administration. AGC believes that most of the modifications under title III of this bill are realistic and desirable and would result in less paperwork and reduced plan administrative costs.

AGC supports the use of supplemental plans, as provided in section 3101, for protecting pensioners from the ravages of inflation, but it is extremely concerned that as presently written, this section may make supplemental arrangements unavailable for use by multiemployer pension plans.

Section 3206 would extend the period for distributing summary plan descriptions from once every 5 years to once every 10 years. AGC supports the easing of this burdensome requirement. However, we strongly encourage subcommittee review of a recent, General Accounting Office study, which questions the need for plans to regularly file summary plan descriptions with the Labor Department.

Section 3308 allows multiemployer plans to calculate credited service for a plan participant only to the extent that the participant's employer contributed the required amount to the plan. AGC supports this proposal to credit service in proportion to contributions actually made. This eases the burden on the average contributing employer to make up for the delinquent contributions of others and is particularly appropriate in situations where the plan involved is a defined contribution plan.

AGC has in the past and continues today to support the need to encourage retirement savings. However, we are strongly opposed to the proposal contained in title V. At a time when Congress, the various executive agencies, and President Reagan himself are trying to reduce the regulatory requirements placed on business by the Federal Government, these provisions do just the reverse: They increase regulation.

As long as employees have the right to establish IRA's on their own, which they now have, it is totally inappropriate to force a payroll deduction system on an employer, given the mobility of employees and employers in construction.

Finally, I would like to say that while AGC fully supports those provisions of S. 1541 which would reduce unnecessary paperwork and improve administration of ERISA, we are also deeply concerned about another very serious problem haunting multiemployer pension plans. The Multi-Employer Pension Plan Amendments Act of 1980 has created many millions of dollars of potential liability for employers contributing to multiemployer plans in the construction, trucking, mining, retail, food, and other industries. The 1980 amendments to ERISA, in combination with the 1978 Connolly decision, have made contributing employers solely responsible for guaranteeing the vested benefits of plan participants. This unilateral liability exists despite the fact that control over plan operations is shared with the union.

AGC's longstanding position has been that employer liability to multiemployer plans should be limited to the per-hour contribution as agreed to in the collective-bargaining agreements. Our testimony and statements to Congress in 1979 and 1980 constantly reenforce the point that any liability in excess of the agreed contribution was inequitable, counterproductive, technically unworkable, and contrary to the principles of collective bargaining which have worked so well in the past years.

The amendments, then and now, defy logic and will ultimately result in the destruction of multiemployer pension plans. AGC is now even more convinced than ever that any law imposing liabilities beyond the bargained contribution levels is unworkable, inequitable, and ill-founded. We strongly urge this committee to restore multiemployer plans to their traditional status. Your colleague, Senator Orrin Hatch, has introduced a bill, S. 1748, to do just that. We ask for your prompt consideration of Senator Hatch's proposal, in addition to your consideration of S. 1541.

Thank you.

[The prepared statement of Mr. Clarke follows:]

TESTIMONY OF

EDWARD P. CLARKE

FOR

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

BEFORE

THE SENATE LABOR SUBCOMMITTEE

November 9, 1981

ON

S.1541

The Retirement Income Incentives and
Administrative Simplification Act of 1981

AGC and its 113 chapters represent:

* 30,000 construction firms;
* 8,500 of the nation's leading general contractors;
* Employment for 3.5 million individuals;
* A $200 billion market;
* More than 80% of the nation's contract construction of commerical buildings, highways and industrial and municipal utility facilities;
* Over 50% of the construction performed abroad by American firms.

My name is Edward P. Clarke, I am Vice President-Operations for Turner Construction Company, New York, New York and am appearing today on behalf of the Associated General Contractors of America (AGC). I am an active member of AGC's Collective Bargaining Committee and ERISA Task Force.

The Associated General Contractors of America and its 113 chapters nationwide represent over 30,000 construction firms; including 8,500 of America's leading general contractors. Together these firms employ more than 3.5 million individuals. They contribute on behalf of their employees to hundreds of multiemployer pension plans established in collective bargaining agreements and maintain single-employer pension plans for their non-represented employees. Our comments today will principally address those sections of S.1541 which affect multiemployer pension plans since multiemployer plans are of more critical importance to construction employers and employees.

Multiemployer pension plans have historically proven to be the best vehicle for providing pension benefits to those construction employees covered by collective bargaining agreements. The construction industry is comprised of many small employers and is characterized by a highly mobile work force. In addition, the project by project nature of construction necessitates frequent lay-offs and hiring as each particular project begins, or progresses from phase-to-phase, or is completed. Multiemployer pension plans by their very nature are ideally suited to these characteristics of the construction industry.

Although these jointly-trusteed multiemployer pension plans provide effective pension coverage, they also present unique administrative problems. Plan participants are constantly changing employers and may on any given day or in any given week not be employed by any contributing employer. Likewise, employers come and go as projects are completed and they move on to other projects in other geographic areas. Additionally, these plans are not "sponsored" by one employer who has unilateral control over the administration of the plan as in the case of a single-employer plan, but are "sponsored" by a board of trustees comprised of equal numbers of union and management representatives. We urge this subcommittee to keep in mind the unique characteristics of construction industry multiemployer plans and take into account their sometimes unique problems during the consideration of S.1541.

Generally, AGC supports the idea of improving ERISA and approves of S.1541 - The Retirement Income Incentives and Simplification Act of 1981. Although the concept of protecting employee retirement benefits is laudable it has become increasingly clear that, in certain areas, the Employee Retirement Income Security Act of 1974 (ERISA) has created more problems than solutions. There can be no doubt that changes are needed in the paperwork, reporting, and disclosure sections of ERISA if our federal pension policy is to be truly workable and equitable. S.1541 goes a long way towards achieving these much needed changes.

AGC would, however, like to point out that there is a potentially more dangerous problem haunting multiemployer pension plans. The Multiemployer Pension Plan Amendments Act of 1980 has created many millions of dollars of potential liability for employers contributing to multiemployer plans in the construction, trucking, mining, retail food, and other industries. The 1980 amendments to ERISA, in combination with the 1978 Connolly decision, have made contributing employers solely responsible for guaranteeing the vested benefits of plan participants. This unilateral liability exists despite the fact that control over plan operations is shared with the union. The 1980 amendments and the 1978 court ruling also reversed years of bargaining history between contractors and unions, who had historically intended and understood that an employer's only liability was to make the agreed-to, per-hour contributions.

The 1980 multiemployer amendments require a plan to assess a withdrawing employer with his pro-rata share of the unfunded vested liability existing in the plan. As more and more plans implement procedures to determine and assess this withdrawal liability there has been a growing number of lawsuits challenging both the constitutionality of the 1980 multiemployer amendments and the mechanics of determining and assessing withdrawal liability.

AGC's longstanding position has been that employer liability to multiemployer plans should be limited to the per-hour contribution as agreed to in the collective bargaining agreement. AGC supported the 1980 multiemployer amendments basically because we were told that the 1980 amendments were the only alternative to being stuck with the 1974 provisions of Title IV, which were worse. Our testimony and statement to Congress in 1979 and 1980 constantly reinforced the points that any liability in excess of the agreed to contributions was "inequitable, counter-productive, technically unworkable, and contrary to the principles of collective bargaining which have worked so well in past years." The amendments then and now defy logic and will ultimately result in the destruction of multiemployer pension plans. No one listened then.

AGC is now even more convinced than ever that any law imposing liabilities beyond the bargained contribution levels is unworkable, inequitable and ill founded. We strongly urge this committee to restore multiemployer plans to their traditional status. Your collegue, Senator Orrin Hatch has introduced a bill - S.1748 - to do just that. We ask for your prompt consideration of Senator Hatch's proposal.

Title I

The establishment of the Employee Benefit Administration (EBA), as provided in Title I of S.1541, would be an appropriate move toward centralized administration of ERISA and related sections of the Internal Revenue Code. The present overlapping authority and duplicative efforts of the Departments of Labor and Treasury and the Pension Benefit Guaranty Corporation (PBGC) have resulted in unnecessary, burdensome reporting and disclosure requirements, over-regulation, and additional bureaucratic red tape. This has increased administrative costs for employee benefit plans dramatically. These increased costs have taken on even greater significance in light of the 1980 multiemployer amendments to ERISA. As employers have become fully responsible for funding pension benefits it has become even more critical that administrative expenses be reduced wherever and whenever possible. Despite the difficulties likely to accompany the initial start-up period of the EBA, AGC supports its establishment.

Title II

Title II of S.1541 addresses the expanded use of Individual Retirement Accounts (IRA's) by persons also participating in a qualified pension plan. Most of the changes proposed in Title II were previously incorporated in the Economic Recovery Tax Act of 1981 (P.L. #97-34) and were fully supported by AGC.

Title III

Title III of S.1541 contains numerous changes to the reporting and disclosure, benefit accrual, fiduciary responsibility, and prohibited transactions provisions of ERISA. AGC believes that most of these modifications are realistic and desireable and would result in less paperwork and reduced plan administrative costs.

Section 3101 would exempt certain supplemental retirement pay plans from the definition of pension plan, thereby, reducing paperwork and other requirements. AGC supports the use of supplemental plans for protecting pensioners from the ravages of inflation, but is concerned that as presently written this section may make supplemental arrangements unavailable for use by multiemployer pension plans. The reason is that Section 3101 requires the Secretary of Treasury to exempt only those supplemental plans which pay benefits out of the general assets of the employer. The very nature of multiemployer pension plans involves a combination of many employers and plan participants and a pooling of monies thereby, making payment of supplemental benefits out of general assets totally impractical. AGC feels that the subcommittee needs to consider the unique characteristics of multiemployer plans and formulate Section 3101 so as to require the Secretary of Treasury to make supplemental plans available to them.

Section 3205 would extend the time period for distributing summary plan descriptions from once every five years to once every ten years. AGC supports the easing of this burdensome requirement, however, we strongly encourage subcommittee review of a recent General Accounting Office (GAO) study which questions the need for plans to regularly file summary plan descriptions with the Labor Department.[1]

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[1] Better Management of Private Pension Plan Data Can Reduce Costs And Improve ERISA Administration, A Report by the Comptroller General, October 19, 1981

This study recommends that the filing of plan summaries with the Department of Labor be totally eliminated. This would not eliminate the need to prepare and distribute a summary to plan participants, but would instead eliminate a costly data collection system that is incomplete and seldom used.

Section 3212 would allow a multiemployer plan to satisfy disclosure requirements by furnishing information to participating employers, who would either distribute the information directly to employees or, in certain circumstances, post it. AGC supports the need to reduce plan administration costs by streamlining disclosure requirements, but has serious doubts as to whether the current proposal would be workable in the construction industry. This provision would allow plan trustees to substantially increase the administrative involvement of contributing employers, in a sense transferring many of the problems and much of the costs to these employers. AGC feels this transfer may create many difficulties in the highly mobile, multi-craft construction industry. One of the many advantages of multiemployer plans to employers and participants alike is that plan administration is centralized resulting in improved administrative procedures and less expense. To now reverse this centralization and return some administration to contributing employers should only be done after full consideration of all the ramifications. AGC pledges to work with the subcommittee and other groups to develop a more workable alternative for our industry.

This section also brings to mind another important weakness of ERISA's disclosure requirements as they relate to multiemployer plans. Very simply, there is currently no clear-cut requirement for mutliemployer pension plans to provide general information on the plan's financial status to contributing employers on a regular basis.

Section 4221(e) of ERISA allows an employer to request certain general information which will allow computation of that employer's withdrawal liability. This provision does not, however, respond to the need for contributing employers to receive information on the plan's financial status on a regular basis, absent an employer request.

The need for contributing employers and prospective contributing employers to be aware of the financial health of a multiemployer plan has become increasingly critical since September, 1980 when the Multiemployer Pension Plan Amendments Act of 1980 was enacted. This Act vastly increased the responsibility for employers to guarantee pension benefits and created enormous, unbargained-for liabilities. In light of these enormous potential liabilities, serious consideration must be given to insuring that employers receive adequate information regarding the plan's financial health.

Section 3308 allows multiemployer plans to calculate credited service for a plan participant only to the extent that the participant's employer contributed the required amount to the plan. This proposal to not credit service in the case of delinquent contributions could only be adopted by a plan which has written procedures for collecting delinquent contributions and which has adopted other required safeguards. AGC supports this proposal to credit service in proportion to contributions actually made. This eases the burden on the average contributing employer to make up for the delinquent contributions of others and is particularly appropriate in situations where the plan involved is a defined contribution plan. Additionally, AGC supports Section 3601 which also addresses delinquencies by broadening the right of plan fiduciaries to collect delinquent contributions. Specifically, Section 502 of ERISA would be amended to allow a multiemployer plan fiduciary to bring civil suit for the collection of delinquent contributions.

AGC also supports Section 3503 of S.1541 which would make it easier for plans to refund mistaken contributions and Section 3707 which would provide for the consolidation of form 5500 with the PBGC-1 form.

Although not being specifically addressed by the subcommittee today, AGC would like to briefly comment on the proposals in S.1541 to modify the fiduciary and prohibited transaction provisions of ERISA as they apply to multiemployer plans. Section 3513 would allow a plan to indemnify a fiduciary against liability for a "good faith" action. Given the complexity of ERISA, the Internal Revenue Code, and the Taft-Hartley Act, AGC fully supports this proposal. Taft-Hartley multiemployer plans depend on the volunteer services of employers and union officials to provide guidance and over-all management. The job of a multiemployer plan trustee is time-consuming and thankless. Recently, there have been an increasing number of court actions to hold these volunteers liable for "good-faith" mistakes. This has forced many trustees to re-evaluate their involvement and has made the search for new trustees especially difficult. AGC strongly supports Section 3513's provisions which will allow plans to indemnify trustees against improper liabilities. This change is critical if we are to have the continued involvement of volunteer trustees.

Section 3505 addresses the current prohibited transactions section of ERISA. Specifically, Section 406(a)(1) of ERISA would be amended to allow transactions between the plan and parties in interest provided such transactions do not inappropriately benefit the party in interest at the expense of the plan. This change would greatly ease paperwork requirements by eliminating the need to request a prohibited transaction exemption in many situations as is now required. AGC supports the concept of eliminating unnecessary paperwork, but feels it is essential that Congress reinforce the need for trustees to maximize return consistent with safe investment and the prudent man rule. This is especially critical in the multiemployer plan setting where contributing employers must shoulder the full burden of guaranteeing vested benefits, while at the same time being required to share investment decision-making with union trustees. Attached is an article from AGC's Constructor magazine (Exhibit #1) which further highlights our concerns in this area.

Title V

Title V of S.1541 would require an employer who does not maintain a qualified pension plan to establish an Individual Retirement Payroll Deduction Plan (IRPDP) unless his employees vote against it. AGC has in the past, and continues today to support the need to encourage retirement savings, however, we are strongly opposed to the proposal contained in Title V. At a time when Congress, the various executive agencies, and President Reagan himself are trying to reduce the regulatory requirements placed on business by the Federal government, these provisions do just the reverse - they increase regulation. As long as employees have the right to establish IRA's on their own, which they now have, it is totally inappropriate to force a payroll deduction system on an employer who does not want to provide such a benefit. In addition, the reference to employee voting is totally inappropriate. There is no current statutory requirement, and rightfully should be no requirement, for an employer to be bound by any so-called vote.

In closing, AGC fully supports those provisions of S.1541 which would reduce unnecessary paperwork and improve administration of ERISA. There are, however, other problems with ERISA which also need to be addressed. We again urge you to consider Senator Hatch's proposal (S.1748) in addition to your consideration of S.1541. Thank you for your time today.

Exhibit #1 Attached - "The Upcoming Conflict," Constructor, July, 1980 pp. 56-57

FXHIBIT #1

LABOR NOTES

By Dennis M. Bradshaw

THE UPCOMING CONFLICT

The 1980s seem headed toward a decade of confrontation between labor and management in the area of fringe benefits. The stage is set for that confrontation to occur at various levels and forums. On the national scene, the first major confrontation started with the pension plan issue. It is scheduled to culminate with the passage of amendments [H.R. 3904/S. 1076] to the Employee Retirement Income Security Act [ERISA]. Essentially, management's responsibilities were vastly increased by Congress with the passage of ERISA in 1974. The various delays to full implemenation of the 1974 Act provisions on multiemployer plans, and dialogues which have ensued, set the stage for a more intensive analysis on the part of labor and management regarding broader pension plan questions.

That analysis, at least on the part of labor, has resulted in a greater awareness and concern, not only of the problems of declining contribution levels of certain plans, but also of the investment opportunities associated with the large sums of money maintained and managed in pension plan funds. That awareness and concern has and will prompt increasing attention of trustees and union officials on how and where pension monies are invested.

In a recent book entitled *The North Will Rise Again, Pensions, Politics and Power in the 1980's*[1], the authors indicated that there are over 500,000 private pension plans with over half of all workers covered under collective bargaining agreements, and a little less than 50 percent of the negotiated plans are multiemployer plans. According to the authors, federal, private, and state pension funds are valued at over $500 billion and pension fund assets will be over $1.3 trillion dollars by the mid-1980s.

The new union awareness of these staggering amounts of monies has resulted in unions asking why some plan assets are being channelled to companies that often operate on a non-union basis. The building trades have and will express their opposition to plan investment in firms such as Halliburton [owner of Brown & Root] and Fluor Corporation [owner of Daniels]. Challenges aimed at firms like IBM, Kodak, Dow Chemical and others will also occur.

Union activity and direction is already developing at the local level. The Washington [District of Columbia] Building and Construction Trades Council recently advised member locals that the Prudential Life Insurance Company of America, which manages millions of dollars of "union" pension funds, uses its funds to finance and build non-union construction projects. The advisory concludes, "With a united effort by all union construction workers, Prudential's non-union building projects can be stopped."

At the national level the Building and Construction Trades Department is seeking to "exempt pension funds from certain prohibited transaction rules which have retarded the use of pension money in real estate financing." The Department's press release announcing the application for exemption is illustrative of current thinking: "Our pension plans contain a tremendous reservoir of benefits which, for the most part, remains untapped. This tremendous economic resource, which is held for the benefit of workers, should be made to work for them in as many ways as possible. This class exemption submitted today is a positive step in that direction."

This effort to control pension plan asset investment decisions comes at a time when employers must be more watchful of and alert to the status of pension plan funding. With or without passage of the proposed multiemployer pension plan amendments, employers bear the responsibility to ensure that benefit promises are fulfilled. Although there will continue to be some acceptable shortfall or under-funding of pension plans, most employers will be striving toward a more realistic funding level. Achievement of the level can be attained through prudent investment decisions with a maximum return and/or through increased contributions. To the extent that the unions' new thrust is consistent with employer objectives in investment decisions, conflict need not develop. However, an investment objective of expanding unionized employment will not necessarily lead to the same decisions as an investment objective of capital growth or maximum income.

Debate over the control of pension plan assets will primarily take place during

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[1] Jeremy Rifkin and Randy Barber, *The North Will Rise Again, Pension, Politics and Power in the 1980's*, Boston, Mass.: Beacon Press, 1978.

EXHIBIT #1 (cont.)

trustee meetings. Yet the overall responsibilities for investments which result in a lesser return will accrue to every contributing employer to a particular pension plan. Such diversions with a lesser yield will add to the unfunded liability of a plan and this in turn is a liability borne by employers on a proportional basis. Management trustees to multiemployer plans already have numerous responsibilities. To that burden they must add the responsibility of communicating union initiated reinvestment attempts to contributing employers.

While this additional responsibility to maintain employer unity and support will exist, it is perfectly compatible with the "prudent man" concept which is certainly in the best interest of pensioners dependent upon responsible administrators of the monies.

Future differences between management and labor trustees over the direction of pension plan asset investments will be an increasing occurrence. Deadlocks, under law, must go to an impartial umpire. In instances where investment differences cannot be resolved, then neutral third-party involvement may be in the best interest of contributing employers and current and future pensioners.

Dennis M. Bradshaw is director of AGC's Collective Bargaining Services.

Senator NICKLES. Thank you, Mr. Clarke. I might repeat my earlier statement that we will be having hearings and will get into the multiemployer insurance provisions at a separate time. We are very, very aware and cognizant of the problems that are involved. We are not wanting to dilute them down into this bill and not be able to cover a lot of the much-needed changes that we believe need to be taken up. That is our real reason for trying to keep them separate.

Looking at your statement, about section 3101, which would exempt certain supplemental retirement pay plans from the definition of pension plan and the corresponding paperwork burden that goes along with that, I saw where it says "AGC supports the use of supplemental plans for taking pensioners from the ravages of inflation, but is concerned that as presently written, that section may make supplemental arrangements unavailable for use by multiemployer pension plans." Would you care to elaborate on that for just a second?

Mr. CLARKE. I believe this has to do with the exemption by the Treasury Department, and it would make it impossible—isn't that true, Dan?

Mr. KENISE. Yes. I think our concern is that the way it is presently written, it requires only the Secretary of the Treasury to exempt those supplemental plans that are paid out of the general assets of the employer, and just by the very nature of multiemployer plans, the pooling of money in one central source, it would be impossible for us to make the payments directly out of general assets. The administrative nightmare of that would make it ridiculous to even try it.

Senator NICKLES. I still did not follow you. Try it one more time.

Mr. CLARKE. In a single-employer plan, the employer could make up the moneys out of his own assets.

Senator NICKLES. And you have no objections to that?

Mr. CLARKE. No.

Senator NICKLES. But under the multiemployer plan?

Mr. CLARKE. Under a multiemployer plan, given the movement of contractors around from city to city to execute work, and the fact that they employ somebody for maybe 3 weeks, 6 months, 4 weeks, and then that employee goes to work for somebody else, there would be no way to administer such a thing.

Senator NICKLES. Let me ask you a question. Do construction firms or firms that have multiemployer-type plans, do they have supplemental plans today?

Mr. CLARKE. No; not that I know of.

Senator NICKLES. So really, the section would not apply, would it?

Mr. CLARKE. No.

Mr. BRADSHAW. We are the exception to the rule.

Mr. KENISE. Well, there are people who are giving them more consideration all the time. One of the problems right now is that the way this is proposed, they probably would not be able to set them up. The difference we have is that our pensions are not tied to any particular employer; they are tied to the plan itself. So you cannot tie any supplemental payment just to any particular employer.

Senator NICKLES. Thinking of the problems that are—and again, I am not wanting to get into the multiemployer pension plans—but I would think that supplemental plans would not be, at least, in the pension programs, you might have a supplemental welfare plan where the employer might say, "The persons who are working for us, we will take care of your health and accident and your dental," or something along that line, in a shorter term, that would be fixed and paid for, or something like that, but not in a longer term pension plan, if you have that revolving work force.

Mr. CLARKE. You might only expect such a plan to occur in a small shop with a relatively permanent work force.

Mr. BRADSHAW. That would be the one exception.

Mr. CLARKE. Somebody who is limited geographically to a given area with a small work force, who is more or less permanent. Usually, in construction, the extent of a project grows for a period, and you end up with employees who are relatively temporary.

Mr. BRADSHAW. Senator, if I might, the particular example you are using is just one illustration of the kind of thinking that goes on, and the kind of thinking simply assumes that single-employer plans and multiemployer plans have similarity. They are not the same. And every time a piece of legislation is written, the differences between the two must be considered, or we end up with administrative nightmares, as Mr. Clarke has indicated.

Senator NICKLES. Mr. Clarke, you have how many employees?

Mr. CLARKE. A varying amount of manual employees would be subject to these plans, but it might be 4,000 to 6,000 at any one given time, throughout the country.

Senator NICKLES. And they are primarily members of the multiemployer plans?

Mr. CLARKE. They would be members of the multi-employer plans. We are involved in at least 100 collective-bargaining agreements around the country, and those would be people who are working under those collective-bargaining agreements.

Senator NICKLES. What about your administrative personnel? Do you have a pension plan for your—

Mr. CLARKE. We have a pension plan for our staff people, yes, and that is an integrated plan, and that is not a problem.

Most of our larger members have their own staff plans.

Senator NICKLES. Mr. Clarke—and I will also open this up for Mr. Bradshaw or whoever would like to answer—do you think it would be advantageous for us to separate Title I of this bill, the Employee Benefit Administration, from the rest of the bill?

Mr. CLARKE. We feel that the Employee Benefit Administration would be well-served to have the multitude of improvements in ERISA all done in one thing and have them be guided by the improvements.

Senator NICKLES. You also suggest in your testimony that employers do not always obtain the information that they would like to have from multiemployer plans. Would you care to elaborate on that?

Mr. CLARKE. Well, particularly traveling contractors, when they propose to take a risk to do a project in a new area, are not familiar with the financial status of any particular multiemployer plans in that area, and they go in and enter collective bargaining agreements through giving their bargaining rights to an association, and they have no way of knowing what the financial status of the plan is. It represents a risk, and there may be a large, unfunded, vested liability in those particular plans.

Senator NICKLES. Do you think that employers should have ready access to plan documents, summary plan description of those plans, actuarial information, et cetera?

Mr. CLARKE. Yes, we do.

Senator NICKLES. And right now, you do not have that information; you have to request that information from the Department of Labor?

Mr. CLARKE. We have tried to receive that information. We are endeavoring to inventory some of that plan information, and it has been very difficult.

Senator NICKLES. Particularly now that you have some liabilities associated with it before.

Mr. CLARKE. Right.

Senator NICKLES. Are your reporting and disclosure requirements different from those of a single employer—here again, multiemployer versus single employer?

Mr. CLARKE. No, they are not, as far as I know.

Senator NICKLES. Gentlemen, we thank you very much for your input, and we also will solicit, of course, your advice, when we get to the other bills that we have discussed.

Thank you very much.

On our next panel, we have Stephen Kellison, who is executive director of the American Academy of Actuaries; and Vincent Rubino, who is vice chairman of the Government Affairs Committee, for the American Society of Pension Actuaries.

Mr. Kellison?

STATEMENT OF STEPHEN G. KELLISON, EXECUTIVE DIRECTOR, AMERICAN ACADEMY OF ACTUARIES, WASHINGTON, D.C., ACCOMPANIED BY GERALD RICHMOND, CHAIRMAN, SUBCOMMITTEE ON ERISA; AND VINCENT RUBINO, VICE CHAIRMAN, GOVERNMENT AFFAIRS COMMITTEE, AMERICAN SOCIETY OF PENSION ACTUARIES, NEW YORK, N.Y., A PANEL

Mr. KELLISON. Thank you, Mr. Chairman.

My name is Steve Kellison, and I am the executive director of the American Academy of Actuaries. With me today is Gerald Richmond, who is chairman of our Subcommittee on ERISA, which prepared this statement.

The academy appreciates this opportunity to testify on S. 1541. The academy is a professional organization of actuaries whose membership includes over 80 percent of enrolled actuaries under ERISA.

Our statement today is limited to provisions which have actuarial implications. However, we do wish to express support for the general direction of the bill.

S. 1541 represents a major step forward in the attempt to find solutions to the problems that have emerged during the seven years since the enactment of ERISA.

In accordance with the ground rules today for this hearing, we are confining our comments to the first five titles of the bill.

However, we do intend to submit additional comments on title VI to you later this month. We are particularly interested in commenting at that time on the proposed changes to the minimum funding standards contained in section 6202.

One issue not addressed in our written statement is the subject of pension terminology. Existing terminology has contained both ambiguities and multiple terms for the same concept. For several years, the actuarial profession has been attempting to produce a set of terminology which is as similar as possible to existing terminology, but which is free of the above defects. I am pleased to be able to announce that during this past summer, a terminology report has been finalized and approved by the governing boards of the various U.S. actuarial organizations, including those here today. We are hopeful that the Congress will look favorably upon this effort and incorporate the new terminology into future pension legislations.

We have copies of the terminology report, which we would be happy to provide. We also intend to supply you with the specific citations in ERISA where we would recommend that the new terminology be adopted.

Our written statement addresses 13 sections of the bill. Since time does not permit me to go through each of the 13 in turn, I would like to comment very briefly on 5 of them.

The first is section 1002. We will limit our comments to the redesignation of the joint board for the enrollment of actuaries as the actuary enrollment board. We recommend that the new name be pension actuary enrollment board, and that enrolled actuaries be redesignated as "enrolled pension actuaries" throughout ERISA.

Our proposed changes are spelled out in appendix B of our written statement.

We believe that these changes will help eliminate misconceptions that have arisen in the nonactuarial community about the credentials of enrolled actuaries in nonpension areas.

Section 3202. This section would make some fundamental changes in the relative roles of actuaries and accountants. ERISA currently provides that the accountant may rely on the work of the actuary, and conversely. This section would change "may" to "shall" and thus require reliance in both directions. We believe that section 103 of ERISA created a clear division of responsibility between the two professions. However, in practice, problems have arisen. Requiring reliance by each profession on the work of the other in their respective defined areas of practice and expertise would be quite beneficial.

We strongly endorse section 3202. We also feel that some additional amendments could be made to further clarify the relative roles of the two professions. These amendments are submitted for the consideration of the subcommittee in appendix C.

Section 3306. We support the changes involving actuarial assumptions contained in this section as properly recognizing the principle of actuarial equivalence. However, we do recommend that the requirement for a separate document be eliminated, since it should be acceptable for such information to be contained in the plan document itself.

Section 3403. We support this section, which would permit the actuary to take into account all future benefit changes for funding purposes This is not only consistent with sound actuarial practice, but would enable the actuary to truly provide the best estimate of anticipated experience under the plan as required by ERISA. This section would solve the problem in which current IRS regulations arbitrarily prohibit recognition of certain benefit increases, for example, those arising from increases in maximum benefit limitations under section 415.

Section 4811, on integration. Current integration rules are quite complex and some simplification would be desirable. Also, they are outdated in certain respects. For example, they fail to recognize the 1977 amendments to the Social Security Act. Thus, we concur that changes to the current rules, either by legislation or by regulation, are in order. However, section 4811 may be interpreted to provide for testing a plan's integration each year based upon plan data rather than testing only the benefit formula once at the outset of the plan. It needs to be clarified that the rules apply to the benefit formula in order to prevent the administrative burden of year to year testing. Also, the bill needs to consider transition rules or allow an extended period for existing plans to adjust, since plans will not know how to comply until final regulations are released.

There has been extensive investigation, including some new literature developed within the actuarial profession, on the integration issue in recent years. We would like to reserve the right to submit additional material on this important subject to the subcommittee as it becomes available.

In closing, I would like to express our appreciation for the opportunity to appear at this hearing, and I do request that our entire written statement be included in the record of the hearing.

[The prepared statement of Mr. Kellison follows:]

STATEMENT OF THE
SUBCOMMITTEE ON ERISA - PENSION COMMITTEE
AMERICAN ACADEMY OF ACTUARIES
RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE SIMPLIFICATION ACT OF 1981 (S. 1541)

November 9, 1981

Stephen G. Kellison, Executive Director

I. INTRODUCTION

The Subcommittee on ERISA of the Pension Committee of the American Academy of Actuaries appreciates the opportunity to present this statement on the Retirement Income Incentives and Administrative Simplification Act of 1981 (S. 1541). The Academy is a professional organization of actuaries and consists of members who work daily with ERISA and the private pension system in general. Over 80% of enrolled actuaries under ERISA are members of the Academy. Appendix A provides some background information on the Academy.

The membership of the Academy includes actuaries with a wide range of views on current pension issues. Certain of the more controversial of these issues are not primarily actuarial in nature. Accordingly, this statement is limited to commentary on items which have actuarial implications. The views expressed in this statement are a consensus of the subcommittee that prepared it, and not necessarily the views of all the members of the Academy.

Although this statement will not specifically address itself to several of the proposals contained in this bill, we are supportive of the general thrust of the bill. ERISA was a most complex piece of legislation which produced implementation problems. In the seven years that have elapsed since its passage, a number of amendments to ERISA that would help achieve its original purposes have been discussed. We believe that this bill, in general, is a highly constructive piece of legislation designed with this worthwhile intent in mind.

We are particularly pleased to see the declaration of policy contained in Section 3(c) of S. 1541 which would add the following to Section 2 of ERISA:

> It is hereby further declared to be the policy of this Act to enhance employee retirement income security by establishing a national policy (1) to encourage the establishment and growth of employee benefit plans, and (2) to encourage savings to meet the needs of employees and their families in the event of death, disability, or retirement.

This statement of public policy is vital, and is a most important addition to ERISA.

One of the lessons ERISA has taught us is that efforts to close perceived loopholes and prevent potential abuses also create complexity and extra costs. At some point such efforts, worthy as they may be, become counterproductive if they result in increased plan terminations and decreased new plan formation. Thus, certain complex requirements which do not have major significance for most plans may create more negative than positive results, even though conceptually the requirements appear desirable. In considering simplifications to ERISA Congress should thus evaluate proposals with the balance between benefits and costs clearly in focus.

In accordance with the groundrules for this hearing we are confining our comments to the first five Titles of S. 1541. We do have a special

Subcommittee on PBGC of our Pension Committee which is reviewing Title VI and this Subcommittee may wish to submit additional material on Title VI at a later date.

II. COMMENTARY ON S. 1541

We would like to comment on the following Sections of S. 1541 which we believe touch on areas of significance to the actuarial profession:

Sec. 1002.	Transfers to the Board of Directors of the Employee Benefit Administration.
Sec. 3101.	Exemption for severance pay and supplemental retirement income arrangements.
Sec. 3202.	Opinions of actuaries and accountants; scope of accountant's opinion.
Sec. 3204.	Conformance with current reporting requirements.
Sec. 3306.	Changes in actuarial assumptions.
Sec. 3309.	Clarification and improvement of joint and survivor annuity requirements.
Sec. 3401.	Clarification of funding standard account; improvement of alternative method.
Sec. 3402.	Approval of changes in funding methods or plan years.
Sec. 3403.	Funding to take account of plan provisions providing for future benefit changes.
Sec. 4306.	Changes in actuarial assumptions.
Sec. 4807.	Clarification of benefit limitation for defined benefit plans where retirement income benefit begins after normal retirement age.
Sec. 4808.	Reduction of amortization period to five years in determining amount of past service or other supplementary pension or annuity credits on which deduction for contributions by employers to pension trusts may be based.
Sec. 4811.	Amendment of integration requirements for plan qualification.

Sec. 1002. Transfers to the Board of Directors of the Employee Benefit Administration.

We should like to limit our comment to the redesignation of the Joint Board for the Enrollment of Actuaries as the "Actuary Enrollment Board."

We recommend that the new name be "Pension Actuary Enrollment Board" and that enrolled actuaries be redesignated as "enrolled pension actuaries."

Sections 3041 and 3042 of ERISA created the Joint Board for the Enrollment of Actuaries to enroll actuaries to perform services required of actuaries under the Act. We would like to comment on two unintended developments which have occurred involving "enrolled actuaries" since the passage of ERISA.

The first is the very name "enrolled actuary" itself. Enrollment under ERISA involves rather narrow credentials to perform certain specific functions, such as providing the actuarial statement required by Section 103(d) of ERISA (contained in IRS/DOL Form 5500 Schedule B). The regulations promulgated by the Joint Board to implement Sections 3041 and 3042 have required satisfaction of certain examination and experience standards involving basic actuarial mathematics and pension actuarial topics related to ERISA. However, the Joint Board has not required evidence of education and/or experience in a variety of other areas of actuarial practice not directly related to ERISA.

Unfortunately, since enrollment essentially involves licensing of actuaries by the federal government (albeit licensing in a narrow area to perform only a small number of well-defined functions), "enrolled actuary" status has understandably but mistakenly been interpreted by many non-actuaries as evidence of broader qualifications. This is not to say that many enrolled actuaries do not possess broader credentials as an actuary, since most do. However, nothing involved in becoming an enrolled actuary is evidence of such broader training and experience per se.

Accordingly, the Academy proposes that the term "enrolled actuary" be changed to "enrolled pension actuary" throughout ERISA. This revised term is much more descriptive of the training and experience inherent in the enrollment process and should lessen the confusion and ambiguity which has occurred.

The second involves the performance of actuarial services for welfare plans (see Section 3(1) of ERISA for a definition of "welfare plan"). Although ERISA affects both welfare plans and pension plans (the latter to a much greater extent), no actuarial statements or reports for welfare plans are required by the Act or subsequent regulations.

The Joint Board requires evidence of both education and experience in pension actuarial matters in order to meet the standards for enrollment. The Joint Board does not require any evidence of either education or experience on welfare plans in order to meet these standards. The Joint Board does not require such evidence in its enrollment regulations, understandably because nothing is required by the government of an actuary on a welfare plan.

This situation involves potential problems of both inclusion and exclusion. On the one hand, the designation "enrolled actuary" does not provide any assurance that the individual in question has competence to perform actuarial services on welfare plans. On the other hand, a number of actuaries that are not enrolled because of lack of education or experience in pension matters may be highly qualified to perform services on welfare plans. Certain problems may arise from this anomaly, since the users of actuarial services are often not aware of these subtleties. For example, cases have been called to the attention of the Academy in which auditors do not rely on the work of an actuary on a welfare plan unless the actuary is enrolled.

The confusion in this area has arisen from the language in Section 3042(a):

> "The Joint Board shall, by regulations, establish reasonable standards and qualifications for persons performing actuarial services with respect to plans to which this Act applies . . ."

(emphasis added)

We wish to propose an amendment to clarify that enrollment involves only pension plans and not welfare plans. This proposal is quite compatible with the first proposal to change the term "enrolled actuary" to "enrolled pension actuary."

Appendix B contains proposed amendments to implement these two clarifications.

Sec. 3101. Exemption for severance pay and supplemental retirement income arrangements.

We would like to comment on the exemption from the funding standards of pension plans of cost-of-living supplements paid out of the general assets of an employer.

The purpose of the proposed exemption is to permit employers to pay pension supplements to offset inflation without also evading the funding standards of ERISA applicable to pension plans. We would like to point out that pay-as-you-go funding under a welfare plan may represent a stronger funding program than is required under ERISA for a pension plan. A plan may be amended to provide an "ad hoc" pension supplement payable for life, e.g., $100 monthly. The present value for a participant aged 65 using PBGC annuity rates at 10% interest is $8,557. ERISA permits funding this over 10 to 30 years. The annual amortization payments (payable in monthly installments) are $1,322 for 10 years and $862 for 30 years. The pay-as-you-go welfare contribution of $1,200 (12 months x $100) is stronger than the 30-year amortization and only marginally lower than the 10-year amortization. Further, ERISA permits adopting an "ad hoc" supplement promised for only one year. Assuming that the tax deduction is to be taken under Section 404(a), then the $1,200 one-year supplement must be amortized over no fewer than 10 years at the rate of only $177 per year. Consequently, ERISA permits a much weaker funding program for a pension plan than for a welfare plan which pays the entire supplement ($1,200) each year.

Both ERISA's present requirements and the proposed exemption permit plan sponsors to systematically make ad hoc increases each year, in effect providing automatic cost-of-living increases while avoiding prefunding these increases over the active working lifetime of employees. Further, no protection of these supplements is provided at plan termination since assets, if available, are allocated only to promised future benefits. Further, PBGC guarantees do not apply to welfare plan supplements.

Consequently, the desirability of the proposed exemption depends on the relative value placed upon the desirability of prefunding promised benefits as generally required under ERISA versus encouraging increased participation of the private pension sector in providing cost-of-living supplements. An important consideration in this regard is that only a very small percentage of private plans presently provide automatic cost-of-living supplementation, although many plans, especially the larger ones, do provide "ad hoc" supplements.

Sec. 3202. Opinions of actuaries and accountants; scope of accountant's opinion.

Section 3202 of S. 1541 would make some fundamental changes in the relative roles of actuaries and accountants in connection with annual reports for plans and we strongly endorse this section of the bill. ERISA currently provides that the accountant may (emphasis added) rely on the work of the actuary, and conversely. S. 1541 would change "may" to "shall," which would provide for compulsory reliance (in both directions, i.e., reliance on actuaries by accountants, and conversely).

Section 103 of ERISA appears to create a division of responsibility between actuaries and accountants. The actuarial statement required by Section 103(d) is concerned with such items as the determination of plan liabilities for future benefit payments and the various computations required to determine whether the plan complies with minimum funding requirements. The financial statement prepared by the accountant pursuant to Section 103(b) is concerned with a proper presentation of the financial status of the pension fund itself.

A problem may arise if the actuarial liabilities are included within the scope of the auditor's opinion. This creates a potential for friction between the auditor and the enrolled actuary. If the auditor chooses to challenge the work of the enrolled actuary, an impasse may result. The enrolled actuary cannot change his/her results, since he/she has already certified them to the federal government as his/her "best estimate of anticipated experience under the plan." Such an impasse, if it developed, would be most unfortunate for plan sponsors, plan participants, and all others concerned.

The provisions of S. 1541 to require reliance by each profession on the work of the other in their respective defined areas of practice and expertise would be quite beneficial in resolving such potential difficulties.

As indicated at the outset, we strongly endorse Section 3202 of S. 1541. We also feel that some additional amendments should be made to further clarify the relative roles of the two professions. These amendments are consistent with the division of responsibility between the two professions which we believe was contemplated by ERISA. These amendments are submitted for the consideration of the Committee in Appendix C. These amendments, coupled with Section 3202 of S. 1541 should resolve the differences which have arisen in this area.

Sec. 3204. Conformance with current reporting requirements.
This Section amends ERISA Section 103(d) by eliminating 103(d)(6), the requirement for an actuarial statement to include the present value of benefits in termination priority categories according to Section 4044 of ERISA. This would legislate the permanent removal of this requirement which is currently waived by Department of Labor regulations Section 2520.104-42. We support this provision because it permanently reduces the actuarial and administrative expenses of pension plans that would arise if the Department of Labor waiver were

removed. Information as to the value of accrued pensions will still be supplied in Schedule B on an optional basis for plans under 100 lives and on a mandatory basis for plans of 100 or more lives.

Secs. 3306, 3309, 4306. Changes in actuarial assumptions. Clarification and improvement of joint and survivor annuity requirements. These sections provide, through the addition of ERISA Section 204(i), that a change in actuarial assumptions used to calculate actuarially equivalent benefits will not be deemed a decrease in benefits if the actuarial assumptions are set forth in a "separate document" available to plan participants. Further they provide that the calculation of death benefits actuarially equivalent to a qualified joint and survivor annuity must be made on the basis of actuarial assumptions in the "separate document" referenced in Section 204(i). The IRC is amended to provide that a plan and trust are to remain qualified if an accrued benefit is altered (reduced) solely by reason of a change in actuarial assumptions set forth in the "separate document" referred to in Section 204(i).

These sections overrule IRS Revenue Ruling 79-90 which requires that the actuarial equivalent basis be specified in the plan document such that a change in the basis may require a plan amendment. If this plan amendment leads to a reduction in an accrued benefit it may disqualify the plan. These sections will now provide that a reduction in benefits due solely to a change in actuarial assumptions is permissible and thus facilitate changes necessary to reflect current conditions.

We support these sections as consistent with the concept of actuarial equivalence. If changing circumstances of mortality and interest indicate that revised factors are needed to maintain actuarial equivalence on a realistic basis, this should not be regarded as a decrease in benefits. However, we recommend that the word "separate" be deleted, since a change in assumptions set forth in the plan document should also not be deemed a decrease in benefits. These sections should permit the actuarial assumptions to be contained in the plan document or a separate document since both approaches are commonly used.

Sec. 3401(1). Clarification of funding standard account; improvement of alternative method.

This section clarifies that changes in actuarial liabilities due to changes in actuarial cost methods are to be amortized the same as gains or losses arising from changes in assumptions. We support this change because changes in methods have a similar effect to changes in assumptions.

Presently, IRS Revenue Prodecures 80-50 and 81-29 require a longer amortization period for decreases in actuarial liabilities due to a change in actuarial cost method than for increases. These Revenue Procedures do serve to strengthen funding requirements, but only marginally. The requirements are difficult to explain to plan sponsors. We believe that equal treatment of increases and decreases in actuarial liabilities resulting from a change in method will enhance the actuary's ability to make appropriate changes in actuarial cost methods as needed.

Sec. 3401(2). Clarification of funding standard account; improvement of alternative method.

This section provides that on a switchback from the alternative funding standard, the deficiency would be amortized over 30 years rather than five years. The purpose of this liberalization presumably is to facilitate adoption of plan improvements. Many actuaries would agree that the present five-year period is unduly harsh. However, many actuaries might also think that 30 years is too liberal an amortization period compared to the 15-year period allowed to amortize a funding waiver. Perhaps a reasonable compromise might be to allow 15 years instead of 30 — the same as for a funding waiver.

Sec. 3402. Approval of changes in funding methods or plan years.
This section would require IRS approval for a change in actuarial cost method only if more than one change is made in a three-year period.

We support this change. The allowable actuarial cost methods are specified in ERISA and regulations. The actuary is free to select any of them at the outset. The enrolled actuary, engaged on behalf of plan participants, must certify on Schedule B that the actuarial method and assumptions used are reasonable and must justify any change in the actuarial cost method. All of this is adequate protection to plan participants. The present rule results in unnecessary actuarial work and fees, and may discourage the actuary from making desirable changes.

Sec. 3403. Funding to take account of plan provisions providing for future benefit changes.
This section would require the actuary to take into account all provisions of the plan, including those which have not yet affected any participant as to entitlement to, or accrual of, benefits. This section also specifically authorizes anticipation of increases in the

maximum plan benefit allowed under IRC Section 415(b)(1). The actuary may also choose not to take account of scheduled benefit increases if he/she so discloses.

We support these changes because they will enable the actuary to reflect all relevant plan provisions in providing his/her "best estimate of anticipated experience under the plan."

Present IRS regulations require treating each increase in the Section 415 maximum as a plan amendment and thus cannot be prefunded. This prevents the actuary from making his best estimate reflecting anticipated future increases and prefunding them.

The proviso that the actuary need not take account of scheduled benefit increases if he/she so discloses will be most helpful in avoiding year-to-year plan amendments in collectively bargained plans which typically have scheduled benefit increases such as $10-11-12 over a three-year period. The actuary would now be able to recognize for funding purposes the $12 benefit beginning in the first year or; alternatively, $10 the first year, $11 the second year and $12 the third year. The interests of plan participants are not harmed by the latter approach because it could be accomplished by three separate amendments anyway, by following present IRS stipulations.

Sec. 4807. Clarification of benefit limitation for defined benefit plans where retirement income benefit begins after normal retirement age. This section would increase the maximum benefit limitation of 100% of high three-year average compensation to the actuarial equivalent of the benefit that would have been payable at normal retirement if the participant defers retirement. ERISA presently does not provide such actuarial increase which would have the effect of increasing the maximum benefit in certain situations (such as late retirement). We express no opinion as to the desirability of so increasing the maximum benefit. We do wish to point out the possible actuarial consequences. The present maximum is independent of age as long as the actual retirement age is 55 or greater. For a plan with a retirement age of 55, actuarial equivalence for deferred retirement to age 65 can be as high as 300% with an interest assumption reflecting present high interest rates. A possible modification would be to relate actuarial equivalence to the later of age 65 or the plan's normal retirement age. The age 65 requirement could be tied to any changes in the earliest age for full pension in the Social Security system (there are currently proposals to increase age 65 to age 68). Even so, fairly large actuarial increases up to the dollar limit in the law would be available, but to a smaller population of participants deferring retirement after age 65.

Sec. 4808. Reduction of amortization period to five years in determining amount of past service or other supplementary pension or annuity credits on which deduction for contributions by employers to pension trusts may be based.

This section amends IRC Section 404(a)(1)(A)(iii) to allow a five-year amortization of past service bases rather than the current ten-year provision. We support this change because it may enhance the benefit security of plan participants by permitting a more rapid funding program (a quicker amortization of actuarial liabilities). The only opposing consideration is a temporary reduction in tax revenues but this would be recouped sooner in future years (five years rather than ten) when deductible past service payments have been completed.

Sec. 4811. Amendment of integration requirements for plan qualification. This section would revise integration rules for offset plans and instructs the Secretary of Treasury to write similar rules for excess plans and for defined contribution plans.

Current integration rules are quite complex and some simplification would be desirable. Also, they are outdated in certain respects, e.g., they fail to recognize the 1977 amendments to the Social Security Act. Finally, in some ways they are inequitable, e.g., the failure to prorate the offset percentage for employees hired at older ages. Thus, we concur that changes to the current rules, either by legislation or by regulation, are in order.

Section 4811 may be interpreted to provide for testing a plan's integration each year based upon plan data rather than testing only the benefit formula at the outset of the plan. It needs to be clarified that the rules apply to the benefit formula, in order to prevent the administrative burden and cost of detailed individual benefit calculations.

Any provision that would require plan amendments for many plans needs to consider transition rules or allow an extended period for existing plans to adjust. The initial effective date should be at least six months after final regulations are adopted, since otherwise plans would not know how to comply, particularly excess plans and defined contribution plans.

There has been extensive investigation including new literature within the actuarial profession on the integration issue in recent years.

In addition, the Academy has another subcommittee specifically studying this issue. We would like to reserve the right to submit additional material on this important subject to the Committee as it becomes available.

III. SUMMARY AND CONCLUSIONS

In summary, we commend the intention of S. 1541 to resolve the difficulties created by ERISA. Many of the proposals in this bill are highly constructive in this regard. The comments presented in our statement are being offered in the same constructive spirit.

The Academy appreciates the opportunity to appear at these hearings. Actuaries have a vital interest in the development of amendments to ERISA and the Academy has a continued interest in this area. Representatives of the Academy are available to meet with the Committee or staff at your convenience to discuss these, or other, proposals in more detail.

Douglas C. Borton, Chairman
Pension Committee

Subcommittee on ERISA
Gerald Richmond, Chairman
William J. Callnan
Willard A. Hartman
Myron Hochheiser
Allan B. Keith
Diane K. Plank
Ross J. Wilson

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APPENDIX A

BACKGROUND INFORMATION ON THE AMERICAN ACADEMY OF ACTUARIES

The American Academy of Actuaries is a professional organization of actuaries which was formed in 1965 to bring together into one organization all qualified actuaries in the United States and to seek accreditation and greater public recognition for the profession. It includes members of three founding organizations -- the Casualty Actuarial Society, the Conference of Actuaries in Public Practice, and the Society of Actuaries.

Requirements to become a member of the Academy can be summarized under two broad headings: (1) education and (2) experience. At the present time, the education requirements for membership can be satisfied by passing certain professional examinations given either by the Casualty Actuarial Society or the Society of Actuaries or by becoming an "enrolled actuary" under the Employee Retirement Income Security Act of 1974 (ERISA). The experience requirement consists of three years of responsible actuarial work.

As of the end of 1980, the Academy membership exceeded 6,200. The Academy is unique as the national actuarial organization for actuaries in all areas of specialization. These actuaries have a variety of types of employment, including insurance organizations, consulting firms, academic institutions, and government. A large majority of those individuals who have satisfied the education and experience requirements of the Academy have, in fact, joined the Academy.

The Academy is active in the development of guides to professional conduct and standards of practice required of members in their professional practice. The Academy is also active in government relations, liaison with other professions, and public relations.

APPENDIX B

PROPOSED AMENDMENT INVOLVING "ENROLLED ACTUARIES"

Sec. 3042(a) The ~~Joint Board~~ Pension Actuary Enrollment Board (hereinafter referred to as the "Board") shall, by regulations, establish reasonable standards and qualifications for persons performing actuarial services with respect to pension plans to which this Act applies and, upon application by any individual, shall enroll such individual if the ~~Joint~~ Board finds that such individual satisfies such standards and qualifications. The term "enrolled pension actuary" means an actuary thus enrolled. With respect to individuals applying for enrollment before January 1, 1976, such standards and qualifications shall include a requirement for an appropriate period of responsible actuarial experience relating to pension plans. With respect to individuals applying for enrollment on or after January 1, 1976, such standards and qualifications shall include —

(1) education and training in actuarial methematics and methodology, as evidenced by —

 (A) a degree in actuarial mathematics or its equivalent from an accredited college or university,

 (B) successful completion of an examination in actuarial mathematics and methodology to be given by the ~~Joint~~ Board, or

 (C) successful completion of other actuarial examinations deemed adequate by the ~~Joint~~ Board, and

(2) an appropriate period of responsible actuarial experience.

Notwithstanding the preceding provisions of this subsection, the ~~Joint~~ Board may provide for the temporary enrollment for the period ending on January 1, 1976, of actuaries under such interim standards as it deems adequate.

Sec. 3042(b) The ~~Joint~~ Board may, after notice and an opportunity for a hearing, suspend or terminate the enrollment of an individual under this section if the ~~Joint~~ Board finds that such individual --

(1) has failed to discharge his duties under this Act, or

(2) does not satisfy the requirements for enrollment as in effect at the time of his enrollment.

The ~~Joint~~ Board may also, after notice and opportunity for hearing, suspend or terminate the temporary enrollment of an individual who fails to discharge his duties under this Act or who does not satisfy the interim enrollment standards.

Conforming Amendments

All references to "enrolled actuary" in ERISA and the IRC are changed to "enrolled pension actuary." This would include redesignating present "enrolled actuaries" as "enrolled pension actuaries."

APPENDIX C

PROPOSED AMENDMENT ON OPINIONS OF ACTUARIES AND ACCOUNTANTS

Sec. 103(a)(3)(A) Except as provided in subparagraph (C), the administrator of an employee benefit plan shall engage, on behalf of all plan participants, an independent qualified public accountant, who shall conduct such an examination of any financial statements of the ~~plan~~ fund, and of other books and records ~~of the plan~~, as the accountant may deem necessary to enable the accountant to form an opinion as to whether the financial statements of the fund and related ~~and~~ schedules required to be included in the annual report by subsection (b) of this section are presented fairly in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Such examination shall be conducted in accordance with generally accepted auditing standards, [except to the extent required by subparagraph (B),] and shall involve such tests of the books and records of the ~~plan~~ fund as are considered necessary by the independent qualified public accountant. The independent qualified public accountant shall also offer his opinion as to whether the separate schedules specified in subsection (b)(3) of this section and the summary material required under section 104(b)(3) present fairly, and in all material respects the information contained in the annual report ~~therein when considered in conjunction with the financial statements taken as a whole~~. The opinion by the independent qualified public accountant shall be made a part of the annual report. In a case where a plan is not required to file an annual report, the requirements of this paragraph shall not apply. In a case where by reason of section 104(a)(2) a plan is required only to file a simplified annual report, the Secretary may waive the requirements of this paragraph.

Sec. 103(a)(3)(B) In offering his opinion under this section the accountant [~~may~~ shall] rely on the correctness of any actuarial matter certified to by an enrolled actuary [~~, if he so states his reliance~~]. The opinion of the accountant under this section is limited to the status and operations in respect to the assets of the fund and excludes actuarial matters certified to by the enrolled actuary. "Actuarial matters" may be further defined by regulation by the Secretary and shall include, with respect to a pension benefit plan, the items required to be included in the actuarial statement under paragraphs (3) through (12) of subsection (d) of this section.

Sec. 103(a)(4)(D) In making a certification under this section the enrolled actuary [~~may~~ shall] rely on the correctness of any accounting matter under section 103(b) as to which any qualified public accountant has expressed an opinion [~~, if he so states his reliance~~].

Sec. 103(b) An annual report under this section shall include a financial statement containing the following information:

(1) With respect to an employee welfare benefit plan: a statement of assets and non-actuarial liabilities of the fund; a statement of changes in fund balance; and a statement of changes in financial position. In the notes to financial statements, disclosures concerning the following items shall be considered by the accountant: a description of the plan including any significant changes in the plan made during the period and the impact of such changes on benefits; a description of material lease commitments, other commitments, and contingent liabilities; a description of agreements and transactions with persons known to be parties in interest; a general description of priorities upon termination of the plan; information concerning whether or not a tax ruling or determination letter has been obtained; and any other matters necessary to fully and fairly present the financial statements of the ~~plan~~ fund.

(2) With respect to an employee pension benefit plan: a statement of assets and non-actuarial liabilities of the fund; and a statement of changes in net assets available for plan benefits which shall include details of revenues and expenses and other changes aggregated by general source and application. In the notes to financial statements, disclosures concerning the following items shall be considered by the accountant: a description of the plan including any significant changes in the plan made during the period and the impact of such changes on benefits; the funding policy (including policy with respect to prior service cost), and any changes in such policies during the year; a description of any significant changes in plan benefits made during the period; a description of material lease commitments, other commitments, and contingent liabilities; a description of agreements and transactions with persons known to be parties in interest; a general description of priorities upon termination of the plan; information concerning whether or not a tax ruling or determination letter has been obtained; and any other matters necessary to fully and fairly present the financial statements of such pension ~~plan~~ fund.

(3) With respect to all employee benefit ~~plans~~ funds, the statement required under paragraph (1) or (2) shall have attached the following information in separate schedules:

(A) a statement of the assets and non-actuarial liabilities of the ~~plan~~ fund aggregated by categories and valued at their current value, and the same data displayed in comparative form for the end of the previous fiscal year of the plan; ----

Note: Amendments contained in brackets are those contained in S. 1541. All other amendments are proposed by the American Academy of Actuaries.

Senator NICKLES. Thank you. All of the statements from our witnesses today will be entered into the record in their entirety.

Next, Mr. Rubino?

Mr. RUBINO. Thank you, Senator.

I am here today on behalf of the American Society of Pension Actuaries, whose 1,800 members provide actuarial and consulting services to approximately 25 percent of the qualified plans in the United States.

The society enthusiastically supports the general thrust of S. 1541, although we have some reservations about some certain, specific provisions, which I will enumerate in a minute.

We feel it is very important that we act now to simplify ERISA, and reduce the burdens imposed by it, to help to strengthen the private retirement system, to enable our country's capacity to provide for the growing number of retired persons to increase.

Specifically, we would like to highlight the following items:

Title I establishes the Employee Benefit Administration, or EBA, to act as a single agency for ERISA administration. We support this concept, as we believe the current overlapping of various agencies involved in the private retirement sector results in gross inefficiencies. We believe, however, that the reality of having only one administrative agency requires serious attention to practical logistic problems. Many of our members have expressed concern as to the continuing role that the IRS may have in such a situation. For example, plan qualification. It is our understanding that the only role that the IRS would retain would be to refer questions of qualifications to the EBA in the case where an IRS agent is auditing an employer and a question as to the plan's qualification arose. We would hope that subsequent legislative history will clear up that instance.

In regard to title II, which allows employees to contribute and deduct up to $2,000 to a qualified plan or an IRA, we feel the Economic Recovery Tax Act has, for the most part, accomplished those objectives. We do support, however, the concept of allowing mandatory as well as voluntary contributions to be deductible to the employees.

In addition, we support deferring the age at which employees must begin withdrawing voluntary contributions to age 75 from the current age, 70½.

Section 3202 provides the requirement that the accountant must rely on the correctness of certified actuarial material. We support this provision and we feel that the bill should go even further to limit the accountant's role to an audit of a plan's assets. We believe this will result in reduced cost to plan sponsors with no reduction in the security of plan benefits.

Sections 3207 and 3208 reduce the distribution burden in regard to summary plan descriptions and notice to interested parties. We strongly feel that the bill should go even further and eliminate, in almost every instance, the requirement for these reports. We feel their utility is minimal, if not nonexistent, and may in fact even cause needless concern or confusion on the part of plan participants.

Section 3306 clarifies that a change in actuarial assumptions used for determining equivalency purposes, will not result in a reduction in accrued benefits. We strongly support this section, with the minor question as to why the assumptions must be part of a separate document, when having them as part of the plan document would provide the same intended purpose.

Section 3402 eliminates the need to request a change in funding method if the change is not made more than once in every 3 years. We strongly support this provision of the act. Most plans do not, as a matter of course, frequently change their funding method, and in most situations, the 3-year requirement will have the practical effect of relieving most plans from this requirement entirely.

Section 3403 allows plans to account for future benefit changes in funding for those plans. We support this in that it not only allows an actuary to make more reasonable best estimate of future experience as required by ERISA, but it also should contribute to the proper funding of a plan.

Section 4807 allows for actuarial increases upon deferred retirement where an individual has reached the 100 percent of compensation limit. We support this and feel that those increases should also be allowed on the dollar limitations of both section 415 of the code and the applicable sections of ERISA. Not allowing actuarial increases on either limit for deferred retirement discourages employment beyond normal retirement age, at a time when deferred retirement should be promoted.

Section 4808 allows a more rapid tax deduction for amortization of a plan's past service liability. We believe that this will provide more flexibility to the employers and should increase the benefit security in the plan.

Section 4811 deals with new integration requirements. While we agree with the concept of equality of total retirement income expressed as a percentage of compensation, as expressed in this section of the act, we believe it should be reviewed in light of practical application. It seems that the proposal requires annual surveillance to insure the limits are not exceeded. We would recommend the development of a system similar to the current system which would allow limits to be built into the initial design of a plan, with no need for continual review or change.

Finally, title V requires mandatory employee deductions, so that the employer would provide a system for employee deductions to an IRA or a simplified plan. We believe the Economic Recovery Tax Act provides ample incentive for employees to save for retirement and do not feel that employers should be required to extend additional incentives, since to do so would require additional expenses for administration and communication.

In summary, I would like to again reiterate our support of S. 1541, and thank you for this opportunity to present our views.

[The prepared statement of Mr. Rubino follows:]

STATEMENT
OF THE
AMERICAN SOCIETY OF PENSION ACTUARIES
TO THE
SUBCOMMITTEE ON LABOR
COMMITTEE ON LABOR AND HUMAN RESOURCES
UNITED STATES SENATE
CONCERNING S 1541
THE RETIREMENT INCOME INCENTIVES & ADMINISTRATIVE SIMPLIFICATION ACT OF 1981

BY
VINCENT RUBINO, VICE CHAIRMAN, GOVERNMENT AFFAIRS COMMITTEE

NOVEMBER 9, 1981

The American Society of Pension Actuaries is a national professional society whose 1800 members provide actuarial, consulting and administrative services to approximately 25 percent of the qualified retirement plans in the United States.

We enthusiastically support the general thrust of S. 1541, although we have some reservations about certain specific provisions. It is very important that we act now to simplify ERISA, and reduce the burdens imposed by it, in order to encourage the private retirement system which is so vital to the country's capacity to provide for the growing number of retired persons.

Specifically, we would like to highlight the following items:

Title I

Establishes the "Employee Benefit Administration" to act as a single Agency for ERISA administration. We support this concept, as we believe the current overlapping of various agencies involved in the private retirement sector (IRS, DOL, PBGC, SEC, EEOC, etc.) results in gross inefficiencies. We believe, however, that the reality of having only one administrative agency requires serious attention to practical logistic problems. For example, some persons have expressed concern as to the continuing role that the IRS would have even though all qualification functions would be transferred to the EBA. Our understanding is that the only role the IRS would retain would be to refer questions of qualification to the EBA in the case where an IRS agent is auditing an employer and a question as to the plan's qualification arose. Currently, an IRS agent sends a check sheet to the Employee Plan Specialist. Under the suggested consolidation, we presume that this check sheet would be sent to the EBA, who would make the final determination with respect to any pension plan question. We would hope that the legislative history will make that clear.

Title II

Allows employees to contribute and deduct up to $2,000 to a qualified plan or an IRA. We feel the major thrust of this Title has been accomplished through ERTA. We do support, however, the concept of tax deductions for mandatory as well as voluntary contributions to a plan. In addition, we support deferring the age at which an employee must begin withdrawing voluntary contributions to 75 from the present 70½.

Title III

Sec. 3101 - We support the designation of severance pay arrangements and supplemental retirement income arrangements as welfare plans rather than pension plans. We feel the resulting elimination of many ERISA requirements will encourage employers to provide these benefits.

Sec. 3202 - We support the requirement that the accountant must rely on the correctness of certified actuarial material. We feel the bill should go even further to limit the accountant's role to an audit of a plan's assets. We believe this will result in reduced cost to plan sponsors with no reduction in the security of plan benefits.

Sec. 3205 - We support the use of simplified annual reports for plans with less than 100 active participants.

Sec. 3206 - We support the less frequent distribution of Summary Plan Descriptions from every 5 to 10 years.

Sec. 3207
and 3208 - We support the reduced distribution burden in regard to Summary Annual Reports and the Notice to Interested Parties, but we strongly believe the bill should go further and should eliminate the requirement for these reports. Their utility is minimal, if not non-existent, and may in fact even cause needless concern or confusion on the part of plan participants.

Sec. 3306 - We strongly suppport everything in this Section, with the minor exception that we do not feel the assumptions need be part of a separate document, since inclusion of the assumptions in the plan document would serve the intended purpose.

Sec. 3307 - Section 3307 should be carefully reviewed to ensure it does not classify as seasonal employers those who would not otherwise be considered as operating a seasonal business.

Sec. 3309 - Although we support the provisions of Section 3309, attention should be paid to the situation in insured plans where the plan administrator has no control over the insurance proceeds. They are normally paid directly by the insurer to the named beneficiary. In this situation, we think that there should be a presumption in the law stating that the participant has elected out of the qualified joint and survivor annuity benefit.

Sec. 3402 - We strongly support the elimination of the need to request a change in actuarial funding method if no more than one change is made every 3 years. We believe that for most plans this will totally eliminate the need to file such a request.

Sec. 3403 - We strongly support allowing the funding of a plan to account for future benefit changes. Not only does this allow the actuary to make a more reasonable "best estimate" of future experience as required by ERISA, but also this should contribute to the proper funding of a plan.

Sec. 3707 - We support all attempts to reduce administrative filing requirements and, therefore, support the consolidation of Forms 5500 and PBGC-1.

Title IV

Sec. 4807 - We support allowing actuarial increases on account of benefit commencement after a participant's normal retirement date where the benefit is at the 100% of compensation limit of Section 415 of the Internal Revenue Code. We believe actuarial increases should also be allowed on the dollar limitations in Section 415 as well. Not allowing actuarial increases on either limit for deferred retirement discourages employment beyond normal retirement age at a time when deferred retirement should be promoted.

Sec. 4808 - We strongly support allowing a tax deduction for a more rapid amortization of a plan's past service liability. Not only will this provide more flexibility to the employers and result in increased benefit security, but the impact on tax revenues should be minimal since a higher current deduction will result in smaller future deductions.

Sec. 4810 - We strongly support the "4-40" vesting as a "safe harbor" provision, as it provides plan administrators with a reasonable, definitive guideline.

Sec. 4811 - While we agree with the concept of equality of total retirement income (as a percentage of compensation) expressed in this Section, we believe it should be reviewed in light of practical application. It seems the integration proposal requires annual surveillance to ensure the limits are not exceeded. We recommend the development of a system (like the current system) which would allow limits to be built into the initial design of a plan, with no need for continual review or change.

Title V

We oppose any requirement for employers to establish payroll deduction plans for employee contributions. We believe ERTA provides ample incentive for employees to save for retirement, and we do not feel employers should be required to extend additional incentives, since to do so would require additional expenses for administration and communication.

Senator NICKLES. Thank you very much, Mr. Rubino. I will just throw a couple of questions out, and either of you may respond to them.

Do either of you know how many actuaries there are in the United States today—I am going to qualify that and put in enrolled actuaries.

Mr. KELLISON. Enrolled actuaries? I think it is very near 3,000. The joint board could give you an exact number, but it is very close to that, in that range.

Senator NICKLES. How many of those are actually working in the pension field, or is that the figure that you are giving us?

Mr. KELLISON. I would guess a large majority of them. Certainly, there are some that may not be currently active. They all have to have been active at one time, in order to have enough pension experience to get enrolled in the first place. So I think 100 percent of them have had pension experience. How many of them are currently active, I would not know, but it is certainly a large majority.

Senator NICKLES. I might pass on to you, at one time, a young individual who was trying to make plans for future livelihood asked me for some advice, and I said, "Well, the way we are going with ERISA, I think you would have a good livelihood if you became an actuary."

Mr. KELLISON. That is good advice—at least, we hope it is.

Senator NICKLES. If I remember in the State of Oklahoma, when we were scouting around in the midseventies for actuaries, we only had a couple of actuaries in the State of Oklahoma at that time. I think it has increased somewhat today. But that is not a lot of competition and would indicate that possibly, with detailed analysis or changes that have been made in 1974, and hopefully some changes that will be made in the near future, it will further increase.

Both of you came out and basically said you supported the change in the language that would require accountants to rely on actuarial statements and actuaries to rely on accountants' statements; is that correct?

Mr. KELLISON. Correct.

Mr. RUBINO. Yes.

Senator NICKLES. Have you actually seen cases where you have given information, say, to the treasurer of a corporation, and there have been disputes, and you have gone back and forth, and actually not really accomplished a mutual goal of coming up with the definitive cost of providing a retirement benefit?

Mr. KELLISON. Well, we have had some of our members who have indicated that that has happened. I have no personal experience with that situation. Certainly, the possibility is there, because the enrolled actuary has to essentially certify to the Federal Government the various actuarial numbers that appear in schedule B. If the auditor of the plan were to come along and challenge those or indicate that he could not give a clean audit opinion unless something were changed in there, you really have an impasse, and it puts the plan sponsor right in the middle. There is no way the enrolled actuary can change what he has done. He has already certified to the Federal Government that it was his best estimate.

It is just an opportunity for a lot of friction and a possibility that the plan sponsor is going to be in a real quandary.

We feel that there was such a clear division of responsibility intended under the original act of ERISA that this section is totally in harmony with that and would let each professional practice in his or her area of competence under the law.

Mr. RUBINO. Senator, I have some personal experience in that regard. I spent 3 years as part of the employee benefits department of a "big eight" accounting firm, and during that period of time, I answered numerous questions regarding the auditing of pension plans from staff accountants who were in the process of those audits. The vast majority of their questions directed toward me were actuarial in nature or with regard to plan administration, areas in which they had no expertise and were not trained for such. And it was clear that they were spending a considerable amount of time and their clients' money to audit sections of the plan, as they read their mandate in the act, for which they were not clearly prepared.

The reality of the situation is that since it is a job that none of them are really prepared for, the lowest guy on the totem pole gets it, and you have a new guy each year doing the plan audit. He is usually the person with the least amount of experience in any area, be it pensions or any other area of accounting. And it simply does not provide a sufficient service to the client. That has been our experience.

Mr. RICHMOND. Mr. Chairman, I am Gerald Richmond, chairman of the pension subcommittee of the academy. The auditors have been fairly jealous in guarding their prerogatives, and maintain that they are responsible for the entire audit, and as such, they would rely on an actuary as a qualified specialist the same that they would rely on a gemologist. And of course, the accountants are not really qualified to judge the competence of the actuary, who has been enrolled by the Federal Government to provide this information. And our amendment in our written statement proposes to clarify this by limiting the accountant's role to auditing the assets and not the plan and to auditing nonactuarial liabilities rather than liabilities, and that that would clearly define the roles of the accountant and the auditor—or, more clearly define them.

Senator NICKLES. We do not have that distinction in our bill today.

Mr. RICHMOND. No; It is in our proposed amendment.

Senator NICKLES. Would you state again your proposal, that accountants would have the authority to audit on the assets of the plan, but not the——

Mr. RICHMOND. The assets, but not the plan itself; that it would be the actuary's responsibility to determine the actuarial liabilities of the plan. And the accountant's role would be limited to auditing the financial assets of the plan but not the plan itself. There is that distinction.

Senator NICKLES. I understand your recommendation, and we will consider that.

Have either of you been in the situation where you have employers that go through all the required computations, and you come up with your minimum and maximum costs, and had employers basically tell you in short form that they are quite a bit smarter than you and that they believe that the contributions should be much higher, or maybe, in some cases, much lower?

Mr. RICHMOND. Not the employer; the auditor might do that.

Mr. KELLISON. I do not know how often that happens. I think it probably happens less today than it used to. Certainly, in the pre-ERISA days, an actuary could have been subject to that kind of pressure. I think today, when you are forced to certify to the Federal Government that something was your best estimate and there is a considerable degree of professional oversight of your work both by the Joint Board within the actuarial profession itself, that an actuary who would succumb to that kind of pressure is treading on a pretty dangerous path. I certainly think that that is a fairly rare situation. I think that the range of the minimum to maximum allowable contributions in most situations is broad enough that that situation would not come up too often. I am sure it does come up once in a while, but I would not say that that was common.

Mr. RUBINO. I would agree with that, Senator. I do not think it happens too often. And I think the fact that the actuary has to personally sign that and put his number down there gives him a defense against doing something that he does not agree with, and not only a defense against the client, but a defense against his superiors who may apply pressure if they think they are losing their client.

Senator NICKLES. I believe one, or maybe both of you, stated your support for less distribution of the summary plan descriptions to participants, or possibly, as you heard mentioned earlier today—I assume that you did—possibly, a more simple summary plan description, or a more simple 5500, and then that form would also be distributed to participants. Do you think that makes sense—let me ask you a very quick question. What information do you think is necessary to hand out to participants on an annual basis?

Mr. RUBINO. Well, in regard to what I said earlier, the summary annual report which we were referring to, I believe the fact that a participant gets a summary plan description when he enters the plan and gets a summary of any material modifications as they occur is sufficient. The information on the summary annual report, I believe, is of no use to the average participant. I believe the number I heard earlier today was that 2 percent even read it. I believe the 2 percent who read it end up with a lot of confusion for their effort.

I believe that perhaps some sort of exception reporting maybe should be developed, in a situation where a plan does come up against emerging liability problems, that is, where the liabilities that are impending are greater than the assets that are anticipated to be there, I do not think the annual reporting of the plan's financial situation serves as any useful benefit or provides any information in its current form to the employee.

Mr. KELLISON. I would agree with that. I think that certainly, the summary plan descriptions and summary material modifications and so forth, if they are read, would convey very useful information. The summary annual report tends to deal very much in aggregates, and I think that does not really provide much in the way of useful information to the individual participant absent some very serious condition of the plan—I suppose, in the large majority of situations where you have a normal plan in operation, it really conveys very little useful information.

Senator **Nickles**. You are talking about the summary annual report.

Mr. **Kellison**. The summary annual report, yes.

Senator **Nickles**. But you do think individual information should be given to the individual participants—the amount of death benefit, if any, their pension benefit, whatever it would be at normal retirement age, those types of things—or not?

Mr. **Rubino**. That is a separate issue, even separate from the summary plan description.

Mr. **Kellison**. Yes; that is a third type of approach.

Mr. **Rubino**. But I think the employee should have access to that sort of information if they request it.

Mr. **Kellison**. I agree.

Senator **Nickles**. But you, Mr. Rubino, in particular, do not even think that we should have a summary annual report, period?

Mr. **Rubino**. That is correct.

Senator **Nickles**. Do you agree with that?

Mr. **Kellison**. Well, I think in its current format, it really is not very useful. And I think the 2 percent is probably about accurate, and much of the information in there is not of very much interest or relevance to the average plan participant. I would like to defer judgment on whether a summary annual report could be structured which might have more useful information, but certainly, the current one, I would have to agree, is of very minimal value.

Senator **Nickles**. Do both of you basically agree with the idea of trying to simplify the annual report to the extent of a very small amount of information, but pertinent to the assets and liabilities nature of the plan?

Mr. **Rubino**. Yes, Senator.

Mr. **Kellison**. Yes.

Senator **Nickles**. Do you spend a great deal of time trying to fill out schedule B of the 5500 for the firms that employ you? Do you have that on computer now, and you are able to whip it out?

Mr. **Rubino**. We do not have a considerable amount of problem with the time involved in filling out schedule B. Our employers, our clients, do have a considerable amount of time involved in gathering the information for the 5500 form itself, though, and we spend a considerable amount of time in guiding them through that process.

Senator **Nickles**. Here again, the employer is required to come up with these reports, the 5500, and yes, we have to have the actuarial statement, and he does not understand the actuarial statement; he employs an actuary, pays him from $3,000 on up to basically come up with this information, and the report stated that most of that information is not looked at for the most part; he looks forward to two things, the minimum and maximum contribution, in most respects. He does not want to know that the plan is financial solvent and moving in the right direction. I know in our firm and others, we receive a nice, detailed booklet of how you calculate the unfunded liabilities, and how you calculate the normal retirement costs, and so on. But really, he is looking for those two things. And possibly, if we could come up with a much more simplified—that is what I think my earlier statement was, that we wanted to do some more work on the reporting and disclosure and see if we could not come up with a more simplified plan and also come up with something that will be of meaning and value to the participant. I would like to be able to have something that could mean something. I think you can flog them with information and lose everything you are trying to gain, but maybe with a simplified report of some nature, that would be of value to the participants.

Mr. **KELLISON**. One suggestion I would make is to look at the under-100-life situation, where there is triennial reporting requirement. As I recall, when this was put into effect, most of the witnesses felt that it was better to have just one form that you can computerize and use every year. What we have now is an attempt at simplification, a different form every third year, which is the long form, and then in the two intermediate years, a so-called short form. And even though that sounds nice in theory, that 2 out of 3 years, you get a shorter form to fill out, in practice, I do not really think it works that way, because this is all on computers. I am a plan administrator for a small plan myself, and last year, for the first time, I had to go in and use a different form, which was shorter, admittedly, but it would have been easier to just look at the old one and complete this year's form from last year's form. So I can sympathize with that. I think this is one area that, in an attempt to simplify things, things were actually made more complicated, and you might want to investigate that.

Senator **NICKLES**. Gentlemen, we appreciate your input, and we would appreciate it if you would continue to work with our staffs and others as far as giving suggestions for some needed changes.

Thank you very much.

On the last panel today, we have James Hacking, who is assistant legislative counsel for the American Association of Retired Persons; Kathy Wilson, who is national chair of the National Women's Political Caucus, and we have Karen Ferguson, who is director of the Pension Rights Center.

Mr. Hacking?

STATEMENT OF JAMES M. HACKING, ASSISTANT LEGISLATIVE COUNSEL, AMERICAN ASSOCIATION OF RETIRED PERSONS, NATIONAL RETIRED TEACHERS ASSOCIATION, WASHINGTON, D.C., ACCOMPANIED BY STEVE ZALEZNICK; KATHY H. WILSON, NATIONAL CHAIR, NATIONAL WOMEN'S POLITICAL CAUCUS, WASHINGTON, D.C., ACCOMPANIED BY CAROL BROS; AND KAREN W. FERGUSON, DIRECTOR, PENSION RIGHTS CENTER, WASHINGTON, D.C., ACCOMPANIED BY STEPHEN BRUCE, DEPUTY DIRECTOR AND STAFF ATTORNEY, A PANEL

Mr. **HACKING**. Thank you, Senator.

I am Jim Hacking, the assistant legislative counsel for the National Retired Teachers Association and the American Association of Retired Persons. These organizations have a combined membership today in excess of 13 million persons aged 55 and older.

Accompanying me on my right is Mr. Stephen Zaleznick, who is a member of our legislative staff.

With your permission, Mr. Chairman, I would like to submit the association's statement for the record of this hearing and proceed to summarize it.

Senator NICKLES. Thank you.

Mr. HACKING. The associations have long maintained that the private pension system must come to play a much more significant and more reliable role in the Nation's retirement income support structure. The changing demographics clearly indicate the need to increase reliance on forward-funded sources for retirement income supplements to assure the adequacy of the total income available to the baby boom generation when it reaches old age. Public policy must recognize this need now, while this generation is still in the work force.

Because of this concern, the associations believe that ambitious goals need to be set for the private pension tier of the income support structure. To reach these goals, the regulatory framework must be strong enough to make pensions reliable for workers and retirees. On the other hand, overregulation must be avoided if employers are to have reasonable incentives to establish and maintain private pension plans for their employees.

With its participation, vesting, funding, fiduciary, disclosure, and insurance provisions, ERISA established basic and long-needed safeguards for private pension plan participants and beneficiaries. But clearly, major problems still exist.

The major problem areas, as we see them, include unduly long vesting schedules, lack of portability, the lack of inflation protection for benefits, the lack of universal coverage, and disincentives that discourage older workers from continuing to work.

S. 1541 represents an effort to cut the costs to business of providing pensions by changing a number of ERISA's requirements, as well as by unifying the administrative entities which have jurisdiction over private pensions. The single agency provisions, as well as some aspects of the tax and termination insurance provisions certainly head in the right direction and should be pursued.

However, S. 1541 contains some provisions which we believe would either not greatly simplify the administrative process or would do so at the risk of undermining one or more of the crucial elements of ERISA. The associations urge the subcommittee to remember that private pensions must be made much more reliable for participants if they are to function adequately and fairly in the retirement income structure of the future. We must begin to discuss means of shortening vesting standards, providing asset portability, and modest inflation protection, and encouraging older people to keep working rather than discouraging them from doing so.

At this point, Senator, I would like to highlight our associations' reaction to a few of the specific provisions of S. 1541.

The associations agree with the goal of title III's section 3101, which would allow companies to provide cost-of-living adjustments for their retirees from their general assets. We are concerned, however, that the treatment of supplemental payments as welfare plans could create some problems. Over the years, supplemental payments could become a major component in the retirement benefit. Yet it appears that these payments could be halted at any time and that little or no warning needs to be given to retirees. We think retirees should be informed as to what portion of their pension they can rely on and what portion is within their employer's discretion.

Sections 3206 and 3207 would reduce information currently available to beneficiaries. We do not think the savings to the plan justify this reduction in information. Making plan amendment and financial information available to retirees is particularly important because the retirees have so little clout in the pension decisionmaking process.

Section 3302 would allow multiemployer plans to additionally burden their retirees, who happen to need to go back to work to supplement their pensions, by imposing forfeitures for months in addition to those in which the work occurs and by allowing for penalties.

Senator NICKLES. What section are you talking about?

Mr. HACKING. I am addressing section 3302, which has to do with the suspension of benefits because of reemployment.

The associations are strongly opposed to this kind of provision. In a continuing inflationary environment, older persons should not have to confront the loss of pension benefits because they choose to supplement those benefits through part-time employment.

Moreover, public policy should begin to move strongly in the direction of encouraging, rather than discouraging, work effort on the part of older persons.

Under title IV, section 4807 would reverse a recent Internal Revenue Service regulation which would not allow a pension plan to provide an actuarial increase to persons who choose to work beyond the plan's normal retirement age. The associations strongly protested this IRS regulation, and we are pleased to see that the bill attempts to clarify this matter.

I understand that title VI is not within the scope of today's hearing. However, since this is our only opportunity to testify before the subcommittee, I would like to make a brief comment on section 6104. This section directs the Pension Benefit Guaranty Corporation to report to Congress periodically on the premium needed to support the existing benefit guarantee level. If the PBGC finds that premiums are too low, it must also provide Congress with a benefit guarantee schedule that can be afforded with existing premiums and with a schedule that raises premiums somewhat and lowers benefit guarantees somewhat. If Congress fails to act, however, the benefit guarantee level automatically drops.

This provision, in our view, would impose a tremendous risk on retirees who could have the system of pension insurance cut out from under them simply as a result of congressional inaction. We think the potential harm to retirees is so significant that any lowering of benefit guarantees should reflect affirmative decisions on the part of the Congress and should not come about simply as a result of a failure to act.

That concludes my remarks, Mr. Chairman. I thank you for having had this opportunity to present them.

Senator NICKLES. Thank you, Mr. Hacking.

[The prepared statement of the National Retired Teachers Association and the American Association of Retired Persons follows:]

STATEMENT

of the

NATIONAL RETIRED TEACHERS ASSOCIATION
and the
AMERICAN ASSOCIATION OF RETIRED PERSONS

before the

SUBCOMMITTEE ON LABOR

SENATE COMMITTEE ON LABOR & HUMAN RESOURCES

on

S. 1541 - THE RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE SIMPLIFICATION ACT OF 1981

NOVEMBER 9, 1981

TESTIMONY ON S. 1541, THE RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE SIMPLIFICATION ACT OF 1981

A. The Need to Take a Thorough Look at Private Pensions

1. The Goals of Private Pensions

The National Retired Teachers Association and the American Association of Retired Persons appreciate the opportunity to present this statement before the Labor Subcommittee. By offering S. 1541, Chairman Nickles has embarked upon a significant review of the Employee Retirement Income Security Act (ERISA). We hope that the Associations can play an active role in the review process.

Before specific provisions of S. 1541 can be effectively evaluated, we feel that the current status of private pensions and the needs of the nation's future retirement system must be analyzed. While some may disagree with its recommendations, we believe that the challenge confronting us was made clear in the final report of the President's Commission on Pension Policy. Using the report of the President's Commission as well as our own research and observations for guidance, the Associations have concluded that private pensions must play an increasingly important role in our retirement income structure for a number of reasons:

a) The changing demographics reveal the need to increase our reliance on forward funded sources for retirement income supplements to assure the adequacy of the total income available to "baby boom" generation when it reaches old age. Public policy must recognize this problem now while this generation is in the work force.

b) Private pensions provide pools of capital, which can be helpful in reversing the nation's current economic problems of intolerably high inflation and little or no growth in productivity and real GNP.

c) Even for present retirees, social security alone cannot provide an adequate retirement income. Private pensions (and a host of other supplements) are needed in order to help make ends meet.

Because of these concerns, the Associations believe that ambitious goals need to be set for private pensions. To reach these goals, the regulatory framework for private pensions must be specific enough to make pensions reliable for workers and retirees. At the same time, over-regulation would be inconsistent with the need for increased business productivity and for the creation of incentives for employers to provide the maximum amount of retirement income for their employees. Balancing these interests should be the dominant theme in discussing changes that need to be made in ERISA, as well as the effectiveness of S. 1541 in offering these changes.

2. Evaluating the Effectiveness of ERISA for Plan Participants and Retirees

With the passage of ERISA in 1974, Congress took a major step in protecting the retirement income of pension plan participants. Prior to 1974, the Associations witnessed the lack of security that workers had in their private pensions. With its development of participation, vesting, funding, fiduciary,disclosure and insurance provisions, ERISA filled a dangerous void in federal involvement in the pension area. Therefore, the Associations feel very strongly that any amendments to ERISA maintain the basic safeguards Congress enacted into law in 1974.

While, because of ERISA, we no longer hear horror stories about workers and retirees being deserted by their employers without a pension, there are still many problems that need to be resolved if the private sector is to be a reliable supplier of retirement income. These problems include:

a) Vesting-- The most common means of vesting under ERISA provides the right to a benefit after ten years of work. This standard conflicts with the reality of a mobile labor force, and it causes many people to lose the opportunity to receive a pension.

b) Portability--Even for those who acquire a vested right to a pension benefit, mobility is still a problem. Pension rights and credits are very rarely portable from the pension plan of one employer to another. As a result, benefits can become frozen when a person leaves a plan; a vested benefit owed a person who leaves an employer at age 45 will be worth very little in an inflationary environment by the time he/she reaches the normal retirement age of 65.

c) The Effect of Inflation--Once a person retires, the impact of inflation on the pension benefit is often severe. Only about five percent of all private pension plans provide automatic inflation adjustments, and even then the adjustments are usually limited to a maximum of around three percent a year. Although many more plans provide ad hoc adjustments, private pension benefits have not kept pace with inflation.

d) Coverage-- The President's Commission on Pension Policy found that in 1975 less than half of the nation's work force was participating in private pension plans. The Commission's forecasts indicate that, without any changes in current law, coverage will not increase significantly in the future.

e) Disincentives for Older Workers--Private pension practices discourage work by any older person through an overly restrictive suspension of benefit rule for people who go back to work and by failing to provide pension credits for people who work beyond the plan's normal retirement age. Discouraging an older person from working benefits neither the affected individual nor the nation's economy.

Because ERISA is such an intricate statute, we would expect any changes to be made on an incremental basis. In fact, S. 1541 appears to constitute a number of such incremental changes that are pieced together into one bill. Each such change, however, must be both responsive to the present shortcomings of private pensions as well as consistent with the protections for workers and retirees that Congress enacted in 1974.

B. The General Approach Taken By S. 1541

S. 1541 is an effort to cut the cost to businesses of providing pensions by changing a number of ERISA's requirements as well as by unifying the administrative bodies which have jurisdiction over private pensions. The Associations recognize that to the extent administrative costs can be cut without harming participant protections, more money can be devoted to paying benefits. Also, simplifying the administrative process can encourage the growth of new plans, and thereby address the coverage problem. We believe that the single agency provisions, as well as some aspects of the tax and termination insurance provisions, head in the right direction and should be pursued by this Subcommittee.

While we do find some positive aspects in S. 1541, there are some provisions in the bill which we believe would either not greatly simplify the administrative process or would do so at the risk of undermining one of the crucial elements of ERISA. Examples are significant reduction in fiduciary protection for some defined contribution participants and the opportunity for retirees to receive lower single-employer benefit guarantees if Congress does not affirmatively raise premiums. (Both areas are subjects for later hearings.) Another example, increased suspension of benefit penalties for people who go back to work, does not constitute an administrative simplification but does constitute a further weakening of federal protections for the older worker.

Also, in reviewing S. 1541, we are stuck by the fact that potential remedies for many of the weaknesses of private pensions are not offered for consideration in the bill. The Associations urge the Subcommittee to remember that private pensions must be more reliable for participants if they are to function adequately and fairly in the retirement income structure. We must begin to discuss means of shortening vesting standards, providing asset portability and modest inflation protection (Sec. 3101 regarding supplemental arrangements is a start), and encouraging older people to keep working by treating their pension credits as any other employee's would be treated. The Associations feel that S. 1541, alone, is not a total response to the nation's retirement income needs.

The provisions of S. 1541 are so diverse that they require separate detailed analyses. While the hearing process could raise issues which have not yet been evident to us, the following evaluation can be conducted on items of particular importance to the Associations.

C. Comments on Specific Items in S. 1541

1. Title I - Employee Benefit Administration

The present system of divided jurisdiction over ERISA between the Departments of Treasury and Labor and the Pension Benefit Guaranty Corporation can cause problems for plan participants. We find that few people are aware of which agency of the federal government can provide information regarding pensions. Also, the larger goals of the governing agencies (i.e. collecting revenue and regulating many labor practices) can conflict with the more specific goals of encouraging pension plans and protecting plan participants. The Associations feel that consolidated jurisdiction needs to be looked at as a possible alternative to the present setup.

2. Title II - Deduction by Certain Employees and Their Spouses for Contributions to Retirement Plans

Because the Associations believe that people should be encouraged to save for their own retirement, we were pleased that the major elements of Title II were enacted into law with the passage of the Economic Recovery Tax Act of 1981. In Section 2005, an element that was not passed by Congress would change current law's restriction that people over age 70½ cannot utilize an Individual Retirement Account and that distributions must commence at age 70½. The Associations support this amendment because current provisions place an unfair tax obstacle on a person who elects to work beyond age 70.

3. Title III - Amendments to the Employee Retirement Income Security Act of 1974

a) Sec. 3101 - Exemption for Severance Pay and Supplemental Retirement Income Arrangements

The Associations agree with the goal of this section to allow companies to provide cost-of-living adjustments for their retirees from their general assets. Present law, as interpreted by the Department of Labor, allows for adjustments that are significantly lower than the rate of increase in the consumer price index.

The Associations are concerned, however, that the treatment of supplemental payments as welfare plans could create some problems which the Subcommittee should address. Over the years, supplemental payments could become a major factor in the retirement benefit. It appears that these payments could be halted at any time and that little or no warning need be given to the retiree.

There should be some ways to lessen these concerns. A provision making longstanding cost-of-living adjustments revert to the plan might be a reasonable approach. At the very least, retirees must know what portion of their pension they can rely on and what portion is within their employer's discretion. This information should be provided to the retiree when the supplemental payment begins.

b) Sec. 3206 - Distribution of Summary Plan Descriptions Every Tenth Year; Sec. 3207 - Publication of Summary Annual Report

Current law requires plans to provide participants and beneficiaries with updated summary plan descriptions every five years if amendments have been made to the plan during that time period. Section 3206 changes this to a ten-year interval. Section 3207 amends the existing practice of furnishing summary annual financial reports to participants and beneficiaries individually. Instead, the employer would be allowed to post the report at the worksite or to publish it in a union or company newsletter.

These cutbacks in information offered by the plans could be particularly harmful to retirees. No indication is given in Sec. 3207 that the summary annual report will be made available to retirees. They are unlikely to see it at the worksite, and there is no assurance that they are recipients of the union or the company newsletter.

Making plan amendment and financial information available to retirees is particularly important because the retirees already have so little clout in the pension decisionmaking process. An enterprising retiree who possesses the relevant information could determine whether investment returns are sufficient to afford limited cost-of-living adjustments for beneficiaries. It is unlikely that anyone else involved in the decision-making process would feel the need to argue this position.

We hope that the hearing process brings out the arguments of plans sponsors indicating reasons why this information provided to plan participants should be reduced. Until then, we hope the Subcommittee proceeds with caution in this area.

c) Sec. 3302 - Suspension of Benefits Because of Reemployment

Section 3302 would allow multiemployer plans to additionally burden their retirees who need to go back to work to supplement their pensions by imposing forfeitures for months in addition to those in which the work occurs and by allowing for penalties. This provision would deviate the existing practice further from the original intent of ERISA Section 203(a)(3)(B)--to withhold the benefits of people who are not actually retired.

The Associations are adamantly opposed to this provision. In the current inflationary environment, retirees should not have to confront the loss of their pension if they choose to supplement it through part-time work. Even current regulations, proposed by the Department of Labor, overly restrict the rights of retirees to go back to work without forfeiting their pension.

Section 3302, furthermore, is contrary to the purported purpose of S. 1541 -- to simplify ERISA. At a time when public policy should be moving in the opposite direction of encouraging older persons to continue to work, this unworthy section should be dismissed by the Subcommittee.

d) Section 3308 - Application of Benefit Accrual Rules in Cases of Delinquent Contributions to Multiemployer Plans

According to this section, a participant in a multiemployer plan will not receive credit for service if his employer is delinquent in making contributions. This shifting of the risk will remove the incentive from the plan's trustees to recoup the contributions. Individual employees will be powerless to remedy the situation. The section requires the plan to notify the union, but there is no assurance that the union will communicate the problem to the workers.

4. Title IV - Amendments to the Internal Revenue Code of 1954

a) Section 4807 - Clarification of Benefit Limitation for Defined Benefit Plans Where Retirement Income Benefit Begins After Normal Retirement Age

This section would reverse a recent Internal Revenue Service Regulation, 26 CFR § 1.415-3, which would not allow a pension plan to provide an actuarial increase to many people who choose to work beyond the plan's normal retirement age. The Associations have protested this provision to IRS Commissioner Egger (a copy of our comments is included as an appendix). Because of the reasons outlined to Commissioner Egger, we are pleased to see this bill attempt to clarify this issue.

b) Section 4811 - Amendment of Integration Requirements for Plan Qualification

Section 4811 attempts to simplify current integration rules by allowing the plan to look at combined benefits (i.e. social security and private pension) as a constant percentage of past compensation for all participating income groups. Additionally, people who earn under the maximum annual wage covered by social security must receive 50% of their 5-year average compensation.

The Associations are concerned that the standard proposed could allow plans to integrate many lower paid workers out of the plan. Questions that need to be asked are whether the constant percentage test provides an adequate portrayal of need across income groups and whether the 50% requirement is too low to provide real protection. The final integration standard need not be unfair and punitive.

5. Title V - Individual Retirement Payroll Deduction Arrangements for Employees Not Covered by Pension Plans

This Title would make it easier for many people whose employers do not sponsor pension plans to get their employers to withhold part of their salaries for IRAs. Given the importance of encouraging people to save for their retirement, this idea is particularly worthwhile.

6. Title VI - Single-Employer Termination Insurance Amendments

Although this Title is not specifically a subject of today's hearing, benefit guarantees are too important a subject to retirees for the Associations to remain silent on the provisions of this Title. Making insolvency of the sponsor, rather than termination, the insurable event for single-employer plans should aid the pension insurance program. However, a number of specific provisions of Title VI cause us great concern that insurance protection for single-employer participants can be stripped away in the future. We urge the Subcommittee to take a careful look at these provisions.

a) Sec. 6104 - Applications of Premiums and Basic Benefit Guarantee Levels for Single-Employer Plans

This section tells the Pension Benefit Guaranty Corporation to report to Congress at least every five years indicating the premium needed to support the existing benefit guarantee level. If the PBGC finds that premiums are too low, it must also provide Congress with a benefit guarantee schedule that can be afforded with existing premiums and with a schedule that raises premiums somewhat and lowers benefit guarantees somewhat (a compromise position). If Congress does not act, the benefit guarantee level automatically drops.

This provision places a tremendous burden on retirees who could have the system of pension insurance cut out from underneath them by Congress' inaction. There is no indication why a provision such as this one is needed. If the expense of premium payments becomes burdensome to business, Congress should then be given the opportunity to change the guarantee structure. However, the potential harm to retirees is so significant that these changes must be affirmative decisions by Congress and should not be due to a failure to act.

Additionally, this section appears to create a tremendous delegation of power to the PBGC. The section does not mention the nature of the guarantee changes. Therefore, a wide array of choices is before the PBGC -- such as an across-the-board cut versus a cut in the maximum benefit guaranteed.

b) Sec. 6123 - Claims for Liability to the Pension Benefit Guaranty Corporation

This section replaces PBGC's present claim for up to 30% of a company's net worth with that of a general unsecured creditor. Therefore, PBGC would have to stand in line with all other unsecured creditors when trying to get money from a company that defaulted on its pension obligations.

This amendment may be needed to help businesses obtain credit. However, it does raise the risk to the PBGC, and this would probably be reflected in premium cost. This section will be a problem because of Section 6104 -- a need for a premium increase can result in lower benefit guarantees. If Section 6104 is changed to protect retirees, this section will become much less of a problem.

Appendix: Letter to IRS Commissioner Egger regarding actuarial increases under Sec. 415.

NATIONAL RETIRED TEACHERS ASSOCIATION
AMERICAN ASSOCIATION OF RETIRED PERSONS

August 18, 1981

The Honorable Roscoe L. Egger, Jr.
Commissioner, Internal Revenue Service
Department of the Treasury
1111 Constitution Avenue, NW
Washington, D.C. 20224

Dear Commissioner Egger:

The National Retired Teachers Association and the American Association of Retired Persons, organizations representing the rights and interests of retirees, are greatly concerned with federal policy affecting the regulation of pension benefits. We therefore would like to take this opportunity to comment on the final IRS regulations on "Limitations on Benefits and Contributions under Qualified Plans," EE-24-78, T.D. 7748, published in the Federal Register, January 7, 1981, at 46 FR 1687.

Of special concern to our Associations are the provisions of Section 1.415-3 of the final regulations establishing limitations on benefits for defined benefit plans. According to the IRS interpretation, the limitations expressed in Section 1.415-3 must be adhered to, irrespective of whether the individual retires at normal retirement age or defers retirement to a later date. Thus, a plan desiring to actuarially increase benefits in a deferred retirement situation will often be forced to deny the retiree such benefits because of Section 1.415-3.

The IRS interpretation of Section 415 raises grave policy concerns. Our Associations, concurring with the position taken by Gerald D. Facciani of the American Society of Pension Actuaries in his letter of July 16, 1981, urge the withdrawal and reconsideration of the relevant provisions of Section 1.415-3.

As a matter of public policy, the Associations feel that Section 1.415-3 must permit plans to provide actuarial increases for individuals wishing to continue employment beyond normal retirement age. Clearly, the Employee Retirement Income Security Act does not prevent adoption of this interpretation. The Act neither expressly nor impliedly prohibits a plan from providing an actuarial equivalent in a deferred retirement situation, thereby warranting the conclusion that any decision to award increased benefits must ultimately be left up to the individual pension plan. Moreover, the current Section 1.415-3 provision frustrates an overriding federal policy aimed at encouraging older workers to remain an integral part of the labor force. Our nation has become increasingly concerned with the rights of older persons, devoting much time and effort toward the passage of legislation to protect and encourage older workers who wish to remain active and productive in our working society. The IRS regulation frustrates this policy, serving, in fact, as a disincentive for continued employment beyond normal retirement age. Workers are actually penalized in this situation, since the provision functions to reduce the value of their accrued pension benefits. An interpretation allowing actuarial increases, on the other hand, furthers the government's efforts to encourage deferred retirement. Acting as an incentive, workers could continue at their jobs without suffering from the decline in value of their pension trust.

A plan electing to actuarially increase benefits need not incur additional costs as a result of the benefit recalculation. Upon retirement, the monthly benefit awarded simply takes into account that portion of the individual retiree's pension fund which would have been awarded had (s)he retired at normal retirement age. A plan enabling older workers to remain active in the labor force without penalty will not only increase the employer's total productivity but will ultimately strengthen the national economy and the federal, state and local tax base.

Additionally, the extra tax dollars contributed by older workers to the Social Security fund will lessen the burdens imposed upon the system by an increasing elderly population and a trend toward early retirement. One can readily conclude that the enactment of such a policy could have far reaching effects on the working community as well as the nation as a whole.

As it stands to date, IRS's interpretation disallowing actuarial increases has no such beneficial effects. The provision not only has a detrimental impact on workers wishing to remain a productive part of our work force, but furthermore it contains serious substantive and procedural deficiencies. Therefore, NRTA-AARP believe that the withdrawal and reconsideration of these Section 1.415-3 provisions are in the best interests of older workers.

Sincerely,

James M. Hacking
Assistant Legislative Counsel

JMH:SZ

Senator Nickles. Kathy Wilson, national chair of the National Women's Political Caucus.

Ms. Wilson. Mr. Chairman, thank you for the opportunity to be here today. With me today is Carol Bros, director of legislation of our organization, and today, we represent not only the National Women's Political Caucus, but the Women's Equity Action League, National Federation of Business and Professional Women's Clubs, National Women's Party, and the Women's Division of the United Methodist Church, all organizations with a special commitment to the issue of women and retirement income.

I request, Mr. Chairman, that the statements of these organizations, along with my complete written statement, be inserted into the record.

Senator Nickles. They will be.

Ms. Wilson. I would like to discuss several sections of S. 1541, the Retirement Income Incentives and Administrative Simplification Act of 1981, that have particular importance for women. But it is necessary to preface my remarks on the bill with an overview of women and pensions.

Let me begin with some shocking statistics. Of all of the aged poor households in the United States, 72 percent are made up of ummarried women; 81 percent of our women citizens over age 65 not living with relatives have incomes below the poverty line, compared with 19 percent of the men.

Older women live in poverty because they are unable to secure adequate retirement incomes, either as workers or spouses. Approximatel.v 31 percent of women workers are covered by pensions compared to 50 percent of men. Just 41 percent of those women have vested benefits compared to 51 percent of the men.

There are many reasons women do not have adequate retirement incomes.

First, the types of jobs in which women workers are concentrated are more likely to have no pension coverage. Over half of all working women are employed in the fields of sales and services—the occupations with the fewest number of pension plans. Even when a woman worker is covered by a pension plan, it is unlikely she will vest her benefits.

Participation requirements for pension plans disproportionately exclude women. Under ERISA, employers are not required to cover employees until they are 25 years old. Yet the age groups with the highest labor force participation for women is from 20 to 24 years.

About 68 percent of all women in this age bracket are employed—more than in any other age group.

Also, women are more likely to work part time or part year, and so may not meet ERISA requirements for the year of service needed for pension credit.

The pattern of low-job tenure for women has a serious negative effect on their ability to accrue vested pension benefits. ERISA does not require vesting more rapidly than 10-year cliff or 4/40. Yet statistics reveal that over half of all full-time workers covered by private pensions have not been at their present jobs for over 10 years. A disproportionate number of those with short-job tenure are women. The median number of years on the job for women in 1978 was 2.6, compared to 4.5 for men. Almost 85 percent of women had been at their jobs less than 10 years.

For the most part, women are stuck in low-paying, dead-end jobs, and during their working career, women often stop paid employment in order to raise children and fulfill traditional family responsibilities. And because women still earn just 59 cents for each dollar earned by the average man, the amount of the pension is unlikely to provide security in retirement.

Because pensions are generally thought to be the property of the wage earner, women also lose out as spouses and survivors.

While ERISA requires that most private pension plans offer joint and survivor benefits, few women, an estimated 10 percent, actually receive survivor benefits. This is crucial for career homemakers who have few options for gaining a retirement income in other ways.

The Economic Equity Act of 1981, S. 888, and H.R. 3117, is now before the Congress. Portions of this bill, which address a variety of women's economic needs, are designed to adjust the current pension system for women. I would like to request that you, Mr. Chairman, and other members of this subcommittee, familiarize yourselves with the provisions of this bill.

The National Women's Political Caucus and many national women's and civil rights organizations fully support the Economic Equity Act as a first step toward rectifying the existing inequities in the pension system.

I would like now to turn to the specific provisions of S. 1541, and I will briefly summarize the points made in our more detailed written analysis.

Section 3309 of S. 1541 would allow defined benefit and defined contribution plans to substitute an equivalent death benefit for a survivor's benefit in certain circumstances. Permitting the substitution of a death benefit—usually a lump-sum payment—may encourage plans to drop life insurance coverage because of the similarity in the form of payment. Overall, this section of the bill would legitimize ways a pension plan can avoid paying joint and survivor benefits and seems to indicate a retreat from the ERISA protections for widows and survivors.

To improve on the protections, we support the provisions of the Economic Equity Act.

In general, the best solution would be to provide survivor benefits in all cases where the worker dies after becoming vested.

Section 3310 deals with alimony and child-support payments and would allow for the division of pension benefits according to the terms of State court decrees, orders, or court-approved agreements on child support, alimony, or marital property rights, making these situations a clear exemption from the ERISA antiassignment provisions. We support inclusion of this exemption in order to place clearly into law recent court rulings.

But the many requirements stipulated in section 3310 make it procedurally unworkable and unduly burdensome.

Section 103 of the Economic Equity Act and the related section of the Civil Service Act are preferable because of their simplicity. These two models allow the courts to order payment with minimal procedural requirements.

We urge the subcommittee to examine these streamlined plans in place of the present section 3310.

Section 4810 would establish a 4/40 vesting schedule as a safe harbor. In other words, if a private pension plan was on the 4/40 plan, it would be presumed to be in compliance with the nondiscrimination provision of the Internal Revenue Code and so eligible for tax-exempt status. While 4/40 is a relatively liberal schedule when compared to 10-year cliff vesting, the minimum required under ERISA, it is not enough protection, and there are circumstances in which discrimination can easily occur.

Because of women's shorter job tenure—due to women's concentration in low-paying jobs, movement in and out of the labor market due to family responsibilities—they do not benefit from a 4/40 plan. This is particularly true in small professional corporations like a doctor's office, where there are few highly paid professionals and a number of lower paid employees. Because the job tenure of the lower paid—usually women—is short, few ever attain vested benefits.

The Government must not sanction pension plans which are blatantly unfair to lower earning employees. We strongly oppose the establishment of 4/40 plans as a safe harbor in which serious discrimination can exist virtually unchecked.

Section 4811 would allow more widespread integration of social security and pension benefits. Because social security is weighted to those with lower earning power, under an integrated plan, the employee's pension benefits can be canceled out or greatly reduced. Again, employers get a tax exemption for plans that too often work to the advantage of only the higher paid.

The National Women's Political Caucus opposes enactment of section 4411 because women are disproportionately among those most hurt under integrated plans.

Women are in the work force to stay. In 1980, 60.8 percent of all women between the ages of 20 and 64 had paid employment—42.6 percent of the total work force. The concern of this subcommittee should be to insure that pension plans better provide for women's job patterns and career homemakers.

The sections of S. 1541 that I have discussed today are steps in the wrong direction. They would undercut the already limited opportunities women have to gain economic security in retirement.

The private pension provisions of the Economic Equity Act are initial moves to make pensions work for women. In reviewing

ERISA, we encourage the subcommittee to look at that important bill. At a minimum, we urge the subcommittee to look in more detail at the problems of women and pensions, and to carefully examine and consider those problems before making any changes in current pension law.

Thank you very much for the opportunity to speak today, sir.

[The prepared statement of Ms. Wilson follows:]

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STATEMENT OF

KATHY WILSON, NATIONAL CHAIR

NATIONAL WOMEN'S POLITICAL CAUCUS

on S. 1541

The Retirement Income Incentives and
Administrative Simplification Act of 1981

November 9, 1981

Before the

Senate Labor and Human Resources Committee
Subcommittee on Labor

Senator Nickles and Members of the Subcommittee, thank you for the opportunity to appear before you today. I am Kathy Wilson, National Chair of the National Women's Political Caucus. The NWPC is a nationwide, multipartisan organization with 55,000 members and 300 state and local Caucuses. The purpose of the Caucus is to obtain equal representation of women in elective and appointive office and to speak out on issues of direct concern to women. Central to reaching that objective is the achievement of equal rights and equal opportunities for women.

I am here today to discuss several sections of the Retirement Income Incentives and Administrative Simplification Act of 1981, S. 1541, that have particular importance for women. But it is necessary to preface my remarks on the bill with an overview of women and pensions.

BACKGROUND: WHY WOMEN ARE NOT RECEIVING ADEQUATE PENSIONS

Let me begin with some shocking statistics. Of all the aged poor households in this country, 72 percent are made up of unmarried women -- those divorced, widowed or single. Eighty-one percent of our women citizens over age 65 not living with relatives have incomes below poverty level, compared with 19 percent of the men.

In 1978, 11.4 percent of Americans lived below the poverty line. For women over age 65, the poverty rate was 16.7 percent.

Older women live in poverty because they are unable to secure adequate retirement incomes -- either as workers or spouses. In 1979, approximately 31% of women workers were covered by a pension plan as compared to 50% of men workers. Of those covered, just 41% of the women had vested benefits, compared to 51% of the men. The reason for this is women's unique employment pattern due to women's role and status in society.

First, the types of jobs in which women workers are concentrated are more likely to have no pension coverage. Over half of all working women are employed in the fields of sales and service -- the occupations with the fewest number of pension plans. To some extent companies are allowed to provide pension plans for some types of employees while excluding others. Often those positions excluded are those with high proportions of women.

Even when a woman worker is covered by a pension plan it is unlikely she will vest her benefits.

Participation requirements for pension plans disproportionately exlude women. Under the Employee Retirement Income Security Act (ERISA), employers are not required to cover employees until they are 25 years old. Yet the age group with the highest labor force participation for women is from 20 to 24 years. About 68% of all women in this age bracket are employed -- more than in any other age bracket. To fail to count these years is a severe disadvantage to women in accumulating pension benefits.

Also, women are more likely to work part-time or part-year, and so may not meet ERISA standards for the "year of service" needed for pension credit. ERISA defines a year of service as at least 1000 hours -- which is 20 hours per week year round or six months at full time -- in a 12 month period. If a woman works less than that, she may get no credit for that work. About 70% of all part-time jobs are now held by women.

The pattern of low job tenure for women has a serious negative effect on their ability to accrue vested pension benefits. ERISA does not require vesting more rapidly than 10 year cliff or 4/40. Yet statistics reveal that over half of all full-time workers covered by private pensions have not been at their present jobs for over 10 years. A disproportionate number of those with short job tenure are women. The median number of years on the job for women in 1978 was 2.6 compared to 4.5 for men. Almost 85% of women had been at their jobs less than 10 years. For workers in the 55-64 age bracket. the median number of years on the present job increased to 14.6% for men and 8.5% for women -- women workers still falling below the ERISA standard for vesting.

For the most part, women are stuck in low-paying, dead-end jobs. With large numbers of women entering and reentering the labor force and with continued wage discrimination and sex segregation in the work place, we can expect this pattern of short job tenure to continue. Also, in these times of economic trouble, women are most likely to be victims of the "last hired, first fired" syndrome.

During their working career, women often stop paid employment in order to raise children and fulfill traditional family responsibilities. This can seriously impair women's ability to gain economic security in retirement. Such breaks in service effect opportunities for vesting, can limit the total pension credits accumulated, and possibly force a woman to forfeit all previously earned credits.

Because of all these factors -- lack of availability of pension plans in occupations in which women are concentrated, pension plan participation rules, slow vesting schedules, and breaks in service -- it is unlikely that a woman worker will be able to gain her unforfeitable right to her accrued pension benefits.

And because women still earn just 59 cents for each dollar earned by the average man, and women on the average have fewer total years of paid employment than men, even where a woman worker is covered by a pension plan and qualifies for her vested right to those benefits, the amount of the pension is unlikely to provide security in retirement. The Census

Bureau reports that in 1979, the average pension benefit for men was $3657, compared to $2186 on average for women -- a difference of $1471. In 1981 this gap actually increased, the average for men being $4103 and for women $2375 -- a gap of $1728.

In sum, women in the labor force are less likely to be covered by pension plans, less likely to ultimately receive pensions benefits, and typically receive lower benefits than men.

Because pensions are generally thought to be the "property" of the wage-earner, women also lose out as spouses and survivors.

ERISA requires that most private pension plans offer joint and survivor benefits -- an annuity of at least 50% of the pension benefit paid to a widow or widower. But the restrictions on these benefits are limiting to the extent that few women -- an estimated 10% -- actually receive survivor benefits. This is particularly crucial for career homemakers who have few options for gaining a retirement income in other ways.

The election of joint and survivor benefits results in the pension benefits being reduced during the wage-earner's lifetime, causing many workers to waive the option. The option can be waived without the consent or notification of the spouse.

ERISA places other stipulations on the joint and survivor annuity so that a number of circumstances must be met before the benefit is payable. The worker and spouse must be married one year before the start of the pension and one year before the worker's death. The worker cannot die before becoming eligible for the survivor benefit. And the worker cannot die within two years of electing the joint and survivor option between early and normal retirement age. The result is that many widows -- expecting and counting-on the benefit --

find it does not exist.

In the case of divorce, ERISA does not expressly provide for ex-wives and state domestic relations courts have varied on this issue.

Many reforms in the pension system are needed to make it equitable. Accelerated vesting schedules are key to improving women's opportunities to acquire adequate pensions in their own right. Changes in participation requirements, breaks in service rules, protability, integration with social security, the use of sex-based actuarial tables, better coverage for widows, divorced women and homemakers is also needed.

Congress now has before it a bill that begins to address the serious problem of women and pensions -- the Economic Equity Act of 1981, S.888 and H.R. 3117. Portions of this bill, which addresses a variety of women's economic needs, are designed to adjust the current pension system to better fit women's work patterns and women's needs. Included in the bill are provisions to:

- lower the minimum age for participation in private pension plans from 25 to 21, to include the years most women are in the workforce to help more women vest their benefits and gain more total years of service
- allow company approved maternity or paternity leave to count as service for vesting and participation accrual, so that mothers and fathers who take time off for family responsibilities are not penalized
- require the written consent of both spouses to waive survivors benefits
- require the payment of the survivors benefit if the participant is vested but dies before retiring

- eliminate the two-year waiting period rule for payment of survivors benefits for individuals who die from non-accidental causes
- establish the pension as a legitimate property right of the marriage, divisable on divorce or for child support or alimony payments.

The National Women's Political Caucus along with many national women's and civil rights organizations fully supports the Economic Equity Act as a first step toward rectifying the existing inequities in the pension system.

COMMENTS ON S. 1541

Joint and Survivor Annuities (Section 3309)

I would like to bring several points to the attention of the Subcommittee related to section 3309, on joint and survivor benefits.

First, this section of S. 1541 would allow defined benefit and defined contribution plans to substitute an equivalent death benefit for a survivor's benefit in certain circumstances and abolish survivor's benefits for spouses of disabled workers and spouses of participants in "individual account" plans. Permitting the substitution of a death benefit -- usually a lump-sum payment -- may encourage plans to drop life insurance coverage of employees because of the similarity in the form of payment. Also, it is unclear such a death benefit would be insured by the Pension Benefit Guarantee Corporation as are joint and survivor benefits.

Section 3309 also permits a participant to designate someone other than his or her spouse to receive the survivors benefit, as long as the spouse agrees to this designation in writing. This may be a means for providing for a former spouse. It is ironic that this bill would require spousal consent here and not require spousal consent when a participant waives the joint and survivor option.

Overall, this section of the bill would legitimize ways a pension plan can avoid paying joint and survivor benefits and seems to indicate a retreat from the ERISA protections for widows and survivors. To improve on the protections, we recommend: 1) require the written consent of the spouse when a participant opts against the survivor benefits, as in the Economic Equity Act, 2) permit those workers who left plans before the ERISA survivor benefit provisions became law in 1976 but who are not yet drawing on their benefits to elect joint and survivor annuities; and 3) eliminate the two year waiting period, where the wage earner spouse still working elects survivors benefits at the early retirement age but dies of natural causes within two years of that election, as in the Economic Equity Act.

In general, the best solution would be to provide surivivor benefits in all cases where the worker dies after becoming vested. This provision, also in S.888, is the best means of protecting widows and survivors.

Alimony and Child Support Payments (Section 3310)

Under current law, ERISA prohibits the assignment of benefits to someone other than the retiree. This provision was inteded primarily to protect benefits from creditors. In recent years, courts have allowed the assignment of benefits to ex-wives under a marital property award or court order for alimony or child support payments, as domestic relations is traditionally the perogative of state law. Though the direction of the courts seems clear, pension plans remain reluctant to go against existing ERISA policy and risk their tax-exempt status.

Section 3310 of S. 1541 provides for the division of pension benefits according to the terms of state court decrees, orders, or court approved agreements on child support, alimony or marital property rights, making these situations a clear exemption from the anti-assignment clause.

We support inclusion of this exemption in order to place clearly into law recent court rulings.

But the many requirements stipulated in section 3310 make it procedurally unworkable and unduly burdensome. This makes a possible trap for those with lawyers unfamiliar with such complicated procedures, who may lose benefits. In this regard, section 103 of S. 888 and the related section of the Civil Service Act (PL 95-366) are preferable because of their simplicity. These two models allow the courts to order payment with minimal procedural requirements.

We urge the Subcommittee to examine these streamlined plans in lieu of the present Section 3310.

Discrimination in Vesting Standards (Section 4810)

Presently, employers who sponsor a pension plan may qualify for a special tax exemption if the pension plan does not favor highly paid employees, officers, and stockholders to the detriment of rank-and-file employees (Sec. 411 (d)(1) of the Internal Revenue Code of 1954). The Congressional Budget Office estimated that federal revenue loss for this exemption for qualified private pensions was $13 billion in FY 80, and projected it to be $25 billion in FY 81.

Section 4810 of S. 1541 would establish a 4/40 vesting schedule as a "safe harbor". In otherwords, if a private pension was on the 4/40 plan it would be presumed to be in compliance with the non-discrimination provision and so eligible for tax exempt status. Under a

4/40 plan, vesting of pension benefits begins gradually after 4 years of service. At four years, the employee's benefits are 40% vested, at five years, 45%, and fully vested only at 11 years of service.

While 4/40 is a relatively liberal schedule (when compared to 10 year cliff vesting, the minimum requried under ERISA) it is not enough protection and there are circumstances in which discrimination can easily occur.

Job tenure for female employees averages 2.6 years. For women workers, the average job tenure does not increase greatly with age. For instance, the average tenure for a women worker aged 45 is just 5.9 years. For men, average job tenure is 4.5 years, and increases to 11 years from men over age 45. In 1978 about twice as many men had been with their current employer for at least 10 years -- 28.6% of the men and just 15.6% of the women.

Because of women's shorter job tenure -- which is due to women's concentration in low-paying, dead-end jobs, movement in and out of the labor market due to family responsibilities -- they do not benefit from a 4/40 plan.

Imagine the following situation: a small professional corporation such as a doctor's or dentist's practice, or a lawyer's office, has one or a few highly paid professionals, usually also stockholders in the company. Working in the office are a number of lower paid employees such as nurses, receptionists or secretaries -- usually women. All the workers are covered by a employer-sponsored pension plan on the 4/40 vesting schedule. But because the job tenure of the lower-paid (women) employees is short, few ever attain vested benefits. Their contributions to the plan simply go to finance the pensions of the professionals and provide the professionals/stockholders with a sizable tax exemption.

Last year the National Women's Political Caucus supported proposed IRS regulation changes that would allow the IRS to better examine how pension plans actually function under the 4/40 rule in order to meet the standards of a "qualified" plan, and to require stricter standards where appropriate. The government must not sanction pension plans which are blatantly unfair to lower-earning employees by providing a tax shelter for employers. Waiting for a pattern of abuse to develop is sufficient protection. Many years would pass and many workers discriminated against before such a pattern would become apparent. We strongly oppose the establishment of 4/40 plans as a safe harbor in which serious discrimination can exist virtually unchecked.

Integration of Social Security and Pension Benefits (Section 4811)

Section 4811 of S. 1541 would allow more wide-spread integration of social security and pension benefits. Under integration, an employer may offset social security benefit from your pension. Because Social Security is weighted to those with lower earning power, under an integrated plan the employee's pension benefits can be cancelled-out or greatly reduced. This is particularly cruel because the vast majority of employees do not fully comprehend how integration will affect their economic security after retirement. They may work for years under the presumption of accruing benefits. The benefits due these employees go to subsidize the pensions of higher-paid employees.

This provision would, in effect, allow dollar for dollar offsets. Again, as with discriminatory vesting schedules, employers get a tax exemption for plans that too often work to the advantage of only the higher paid.

Virtually all workers earning under the social security wage base figure -- $29,700 a year in 1981 -- are hurt by integration.

The National Women's Political Caucus opposes Section 4811 because women are disproportionately among those most hurt under integrated plans.

CONCLUSION

Women are in the workforce to stay. In 1980, 60.8% of all women between the ages of 20 and 64 had paid employment -- 42.6% of the total workforce. The concern of this Subcommittee should be to ensure that pension plans better provide for women's job patterns and career homemakers. The sections of S. 1541 that I have discussed today are -- if enacted -- steps in the wrong direction. They would undercut the already limited opportunities women have to gain economic security in retirement.

The private pension provisions of the Economic Equity Act, S. 888, are initial moves to make pensions work for women. In reviewing ERISA, we encourage the Subcommittee to look at that important bill. At a minimum, we urge the Subcommittee to look in more detail at the problems of women and pensions, and to carefully examine and consider those problems before making any changes in current pension law.

Thank you.

Senator NICKLES. Thank you, Ms. Wilson.

Next is Karen Ferguson, who is director of the Pension Rights Center.

Ms. FERGUSON. Thank you, Mr. Chairman. I am Karen Ferguson, director of the Pension Rights Center. Appearing with me today is Stephen Bruce, the center's staff attorney.

I will make a very brief opening statement, and Mr. Bruce will discuss the specific provisions of S. 1541.

The Pension Rights Center is a nonprofit group organized to protect the pension rights of workers, retirees, and their families. We are here today because we share your conviction that more workers should "retire with an income from a private pension system," and because we are concerned that rather than providing more pensions for more people, S. 1541 would result in even fewer workers retiring with income from a private pension plan.

Before Mr. Bruce details how people would lose pensions and other important rights under this bill, I would like to make two more general points. The first is that the contention that paperwork and administrative burdens have caused plans to terminate or have discouraged employers from setting up new plans has been disproved time and time again. In 1978, the GAO pointed out that this was not the reason plans were terminating, and more recently, IRS statistics have shown that there has been no negative impact on new plan growth.

The second and most important point is that for employers who genuinely want to provide pension benefits for their employees, there is no bureaucratic red tape, there is no unnecessary and burdensome paperwork. These employers can simply call the IRS for a copy of its prototype, simplified employee plan, go to the nearest financial institution, and in a very few minutes, set up a very substantial retirement income arrangement. Under a simplified employee plan, employers can contribute up to $15,000 a year for themselves, the only requirement being that they provide the same percentage of pay for their employees. Over a 25-year period, this could produce an accumulation of more than a million dollars for the employer's own pension. The only paperwork is this one-quarter-page form.

The fact is that the so-called burdensome paperwork addressed by S. 1541 is not required by pension law. It only arises when employers want to provide benefits to one segment of their work force, or when they want to retain effective control over plan assets. The degree of burden and paperwork depends directly on the extent of discrimination an employer wants to factor into a plan, how many employees he or she wants to exclude through participation standards or a vesting schedule or under an integration formula, and how much control over plan assets he or she wants to keep.

It is only if a plan is structured to pay off to some, rather than all participants, that the law requires adherence to complex rules. If a plan is structured to pay off to all participants, there are no such rules. There is no complexity.

It is only if a plan pays benefits to a relatively few participants that meaningful disclosure becomes a burden. Detailed disclosure is required simply because it is considered to be only fair to alert people to the fact that they may not get benefits.

In the financial area, the requirements of the law reflect the real world fact that pension money offers a tremendous temptation. If employers do not want to bear the cost of providing one-page statements to participants or of getting clearance for potentially questionable transactions, they have the option of giving up control of the money. In other words, there is no need for employers, particularly small employers, to incur paperwork and administrative costs, and properly, many should not. If an employer with only seven employees has an integrated, defined benefit plan with a 4/40 vesting schedule, he is voluntarily taking on substantial actuarial and legal costs in order to save considerably more money by denying benefits to many of his employees. He is making a deliberate cost-benefit trade off. He is adopting a plan that will so enhance his own retirement income and provide so many estate and corporate tax advantages that those benefits will far outweigh the paperwork and administrative costs that are necessary to protect workers and retirees.

Stephen.

Mr. Bruce. I am going to summarize our statement concerning certain key provisions in S. 1541 that affect substantive pension rights and disclosure.

The "plan year" and "elapsed time" provisions of the bill have been proposed as administrative simplification. These provisions would, however, subtly increase the years required to vest in a pension by on average, a full year. We have no difficulty with simplification in these areas, but the proposals can and should be structured so as not to extend the period required to vest.

The basic 10 years in the law is already far too long. Average job tenure in the United States is 3.6 years. We should not forget that this seemingly short job tenure is not, by and large, voluntary. Plant closings all over America are bitter reminders to millions of workers of the tenuousness of their jobs. And among small employers, turnover and business failure are always high.

We should be taking into account the realities of jobs in America today, and moving toward vesting benefits at average job tenure rather than at a more extended period.

Section 4811 of the bill, the integration proposal, is also proposed as administrative simplification. As structured, however, it would hurt those employees who are most in need of pensions, more seriously, than any other proposal in the bill.

Under section 4811, a person could work 40 years for a company with a pension plan and still not receive a cent in pension benefits because the plan was integrated or, as some would say, coordinated, with social security. The minimum provision in section 4811, the "50 percent combined benefit rule," will not work. Even workers at above average earning levels receive over 50 percent replacement from social security alone. This means that under that test they would receive no pension benefits. If there is concern about these workers receiving excessive income in retirement, that concern is most properly addressed through simple caps at reasonable replacement rates. Beyond this, social security earnings and pension benefits should be kept separate. social security integration is outdated, far too complex, and unfair. Under current law and under this proposal, it results in unreasonable and unnecessary administrative expenses—this proposal, for example, provides for up to three different calculations for each benefit type.

Turning to survivors benefits: The provisions contained in section 3309 would chip away at the provisions for survivors annuities contained in current law. We have no problems with lump-sum options or single-life annuities, but as a matter of sound national policy, the primary form must continue to be the joint and survivor annuity. The lump-sum and single-life annuity should be available as elections, but they should be available only with the consent of the spouse. Too many people cannot bring themselves to tell their wives that because of the small size of their benefits, they had to elect out of the joint and survivors benefit because it would have reduced those benefits further.

Section 3308 of the bill would deny pension credit to workers whose employers are delinquent in making contributions to multiemployer plans. This provision would take away the multiemployer plan's incentive to collect the delinquencies because there would be no plan liability. The multiemployer plans have ample statutory authority to collect those delinquencies under recent amendments to ERISA which provide for interest, attorneys' fees, and liquidated damages up to 20 percent of the delinquent amount.

Section 3302 relating to the suspension of benefits would allow multiemployer plans to take away up to a year's pension benefits from a pensioner who returned to the trade or craft he or she had practiced for so much as a day. This would widen the existing disparities in the law between single and multiemployer plans, and it is not the sort of proposal that should be in a pension bill. It is a job preservation proposal.

On the reporting and disclosure provisions: The provisions in the bill have been touted as administrative simplification. If enacted, however, they would seriously cut down on the information that employees receive and would cut down on the confidence that employees have in their pension plans. They would not significantly reduce costs.

Employers and benefit administrators should recognize that disclosure in the best plans is to assure the employees that they will receive benefits and that their plan is financially sound; in the worst cases, it is to enable the participants to detect abuses and to instigate action to correct abuses when they occur.

With regard to the summary annual report and posting: The cost savings from this are almost nonexistent. As you heard Mr. Harris from the Small Business Council say last Wednesday, it is simply "no big deal" to run off 10 copies of a 1-page form. And producing the SAR simply involves transposing numbers directly from the 5500 or 5500-C.

Congressman Erlenborn's statement on Wednesday that "employees don't want to know all the technical information in the SAR" is counter to the results of the only national poll ever conducted on this subject. That poll, conducted by Louis Harris & Associates in 1979, shows that employees do think it is important that they receive information on the financial status of the plan.

In the past few weeks, there have been hearings in both the House and Senate on pension fraud and abuse, and there has been extensive newspaper coverage of transactions involving pension funds in the Grumman and in the A. & P. cases. Employee concern about the financial operations of their pension funds is, if anything, increasing every day.

As we are not scheduled to testify on Thursday, let me offer one brief comment on the insurance provisions. Section 6104 would undermine the Federal pension insurance program. The PBGC's guarantee is always subject to reduction by congressional action, but to make it reduceable through congressional inaction, as this section would, would completely do away with the confidence that participants have developed in the program.

Let me say in conclusion that we need to be strengthening the public's confidence in having income for retirement. I am afraid that this legislation would make the prospects of people getting pension benefits even bleaker than they are today. Its only benefits are a highly speculative increase in new plans, new plans that would be neither financially sound or fair.

We are preparing a detailed analysis on the bill which we would like to submit before the record of these hearings closes.

I thank you very much for the opportunity to appear here today.

Senator **Nickles**. Thank you, Mr. Bruce.

[The joint prepared statement of Ms. Ferguson and Mr. Bruce follows:]

STATEMENT OF
KAREN W. FERGUSON AND STEPHEN R. BRUCE
BEFORE THE
SENATE LABOR COMMITTEE
WASHINGTON, D.C.
NOVEMBER 9, 1981

Mr. Chairman, Members of the Subcommittee, I am Karen W. Ferguson, Director of the Pension Rights Center. Appearing with me is Stephen Bruce, the Center's Deputy Director and Staff Attorney. I will present our opening statement. Mr. Bruce will discuss specific provisions of S. 1541.

The Pension Rights Center is a nonprofit group organized five years ago to educate the public about pension issues to protect the pension rights of workers, retirees and their families and to offer solutions to the nation's retirement income problems.

We are here today because we share your conviction that more workers should "retire with an income from a private pension system."

As you have noted, Mr. Chairman, social security is facing a financial crisis and personal savings represent a small percentage of spendable income. That leaves private pensions as a critically important means of meeting "the needs of retiring Americans." Yet despite the $478 billion in private pensions, only 1 out of 4 people in the private work force have the right to receive a pension at retirement age. If the private pension is to continue to play a a major role in meeting the nation's retirement income needs, it is essential that more workers receive income from a private pension plan. We are concerned that rather than meeting the needs of retiring Americans, S. 1541 will result in even fewer workers retiring with income from a private pension plan.

S. 1541 is predicated on the assumption that "present laws have led to a reduction in the number of pension plans being created today, and have.....increased the number of plans folding." That assumption has been repeatedly disproved. The evidence is to the contrary. Recent IRS statistics show a growth in the number of new plans (the number of participants in those new plans, while fluctuating from year to year, has remained roughly constant.) As for plan terminations, the GAO found in April, 1978, that where employers terminated plans because of ERISA "the terminating plans generally did not meet the act's minimum participation and vesting requirements designed to make sure that employees would benefit from a pension plan without having to meet unreasonable years worked and age requirements." In enacting ERISA Congress specifically intended that plans with unreasonable requirements be amended or terminated. The policy of the Act was expressly stated: "to protect.....the interests of participants in private pension plans and their beneficiaries by improving the equitable character and soundness" of pension plans.

S. 1541 proposes to change the policy of the Act dramatically. According to Congressman John Erlenborn, the "declared policy of ERISA" would be "the expansion of the private pension system." This policy and the specific provisions of S 1541 would return us to the pre-ERISA days when pension plans were sold to small businesses as tax shelters to pay benefits to company officials. It would allow plans to go back to denying pension benefits to lower paid and shorter service employees, the employees most in need of a pension. For these employees a pension is a matter of survival. They simply cannot make ends meet on social security benefits now averaging $4524 a year.

What S. 1541 fails to recognize is that for employers who genuinely want to provide pension benefits for their employees, there is no "bureaucratic red tape" and there is no "unnecessary and burdensome paperwork." These employers simply call or write the IRS for a copy of its prototype Simplified Employee Plan, go go to the nearest financial institution and, in a very few minutes, can set up a most substantial retirement income arrangement. Under a SEP employers can contribute up to $15,000 a year for themselves. The only requirement if that they provide the same percentage of pay for those of their employees who have worked at the company 3 out of the preceding 5 years. (In fact, SEPs can even be "integrated" with social security, allowing employers to provide disproportionately more pension benefits for themselves than for

for their lower paid employees.)

The alleged "burdens" and "paperwork" addressed by S. 1541 are not required by pension plans or the pension law. They only arise when employers wnat to provide benefits to one segment of their work force or when they want to retain effective control over plan assets. The degree of burden and paperwork depends directly on the extent of discrimination an employer wants to factor into the plan--how close he or she wants to the limits of permissible discrimination. How many employees he/or she want to exclude through the participation standards, by a vesting schedule or under an integration formula--and how much control over plan assets he or she wants to keep.

If a plan is structured to pay off to some, rather than all participants, the law requires that the plan adhere strictly to complex rules that carefully detail exactly who can and cannot be excluded. If a plan is structured to pay off to all participants there are no such rules. There is no complexity.

Similarly, the law requires that those plans paying benefits to only relatively few participants must provide participants with updated, clear and meaningful disclosure about the terms of the plan. This is sound public policy it is only fair to alert people that they may not receive benefits.

In the financial area, the law requires plan trustees to tell people how well their pension money is being managed and provides a check on whether trustees have engaged in self-dealing. These requirements reflect the real world fact that pension money offers a great temptation. If employers do not want to bear the cost of providing one page statements to participants and clearing potentially questionable transactions, they have the option of giving up control of the money.

There is no need for employers--particularly small employers--to incur paperwork and administrative costs. Properly, many should not. If an employer with only seven employees has an integrated defined benefit plan with a 4/40 vesting schedule, he is voluntarily taking on substantial actuarial and legal costs. If he wants to retain control over the investment of the fund's monies, the costs will be even higher. The only justificiation for maintaining this kind of plan--which will inevitably deny benefits to most of his employees--is that it will so enhance his own retirement income and provide so many estate and corporate tax advantages that those benefits will far outweigh paperwork and administrative costs. He is making a trade off: More benefits for himself in exchange for slightly higher costs.

If this Subcommittee is concerned with holding plan costs to small business down, we suggest that, rather than taking away much need protections from employees and retirees, you take an in-depth look at the kinds of pension plans being "sold" to small businesses by insurance companies and actuarial consulting firms. Do these plans meet the needs of small employers? Are they justified in terms of federal tax policy which requires all American taxpayers to pay higher taxes to subsidize these plans?

(The cost of private pension plans to the Treasury has now reached an astronomical $23 billion a year.) And, most important, how consistent are these plans with your objective of providing pensions "to meet the needs of retiring Americans."

The bill (S.1541, H.R.4330) would cut back on a number of substantive pension rights; deny employees and retirees information about the terms and operations of their pension plans; undermine the federal guarantee for pension benefits; and remove basic safeguards against misuse of pension fund money.

Substantive provisions: The "plan year" and "elapsed time" provisions of the bill, Sections 3301 and 3311, would subtly increase the years required to vest in a pension by, on average, a full year. The basic 10 year cliff in the law is already far too long. Average job tenure in the United States is 3.6 years. We should not forget that short job tenure is not by and large a voluntary phenomenon. Plant closings all over America are bitter reminders to millions of workers; and, among small employers, turnover and business failure are always high.

Sections 3301 and 3311 would exacerbate rather than help with the vesting problem. We have no difficulty with simplification in the determination of eligibility to participate and the calculation of years of service, but this can and should be structured so as not to extend the period required to vest.

We should be taking into account the realities of job tenure in America today, and moving towards full vesting at the average.

The time and expense that have gone into the efforts to retain the so-called "safe harbor" for plans where facts and circumstances show blatant discrimination in vesting are shameful. A woman who works in a law office in New York City calls her office a "railroad." No one stays, except the partners. This theme repeats itself in small offices all over the country. If we want a pension system that pays off only for very, very highly compensated people then we can keep ineffective "safe harbors" such as 4/40 vesting. We should not, however, delude ourselves with statements about benefits being provided to a cross section of Americans.

Section 4811 of the bill would hurt employees more seriously than any other proposal in the bill. Under Section 4811 a person could work 40 years for a company with a pension plan and still never receive a cent, because the plan was "integrated," or as some would have it, "coordinated" with social security. The "50% combined benefit rule" in Section 4811 is, to put it mildly, nonsense. Even workers at above average earning levels receive over 50% replacement from social security. If there is concern about workers receiving "excessive" income in retirement when social security and the pension are combined, the concern is most properly addressed through "capping" at a reasonable replacement rate (90 to 95% of compensation for lower paid employees, 80 to 85% for those at average earning levels). Beyond this, social security integration is outdated, far too complicated and unfair. It also results in unreasonable and unnecessary administrative expenses.

Turning to survivors benefits: poverty among older women is a fact, and for the foreseeable future, most older women who are poor are going to be women who stayed at home while their husbands worked, and did not build up any pension on their own account. The provisions contained in Section 3309 would decrease the chances that these women might receive survivors' annuities from their husbands' pension plans. This is a step backwards. We have no problems with lump-sum options or single-life annuities, but until changing work patterns in our society work their full course, the primary form, as a matter of sound national policy, must be the joint and survivors'. The lump sum and single life annuity should be available as elections, but, I might add, only with the consent of the spouse. If you have not thus far, you will in due time receive letters from widows whoe husbands couldn't bring themselves to tell their wives that because of the small size of their benefits they had to elect out of the joint and survivors benefit.

Section 3308 of the bill would deny pension credit to workers whose employers are delinquent in making contributions to collectively-bargained multiemployer plans. This would take away the multiemployer plan's incentive to collect the delinquencies and is a strong invitation to abuse. The multiemployer plan has the responsibility, and ample statutory authority to collect, including provision for interest, attorneys' fees and liquidated damages up to 20% of the delinquent amount, under Section 502(g) of ERISA.

Employees have no such powers and would be without recourse if the multiemployer plan refused to collect payments. If Section 3308 were law, we would see more "sweetheart" deals between plan trustees and employers because the incentive to collect that exists now (namely to hold plan liabilities down) would be eliminated.

Section 3302 would allow multiemployer plans to take away up to a year's pension benefits from a pensioner who returned to the trade or craft he or she practiced for so much as a day. This is an antiquated job preservation proposal that would widen existing disparities in the law between single and multiemployer plans. It fails to take into account the need for many retirees to return to work to supplement inflation-eroded fixed pensions. The penalty provisions in Section 3308, moreover, are without any provision for due process.

Reporting and disclosure provisions: The provisions in the bill on reporting and disclosure provisions have been touted as administrative simplification. If enacted, however, they would seriously undercut informational requirements that are essential to employee confidence, and would not significantly reduce costs. Employers and benefit administrators should recognize that many of these requirements are "assurance" provisions. Pensions are the largest asset that many employees have. That being the case, there is a need for assurance that nothing has gone wrong and that none of the plan's terms have been changed.

To put this into perspective, I would like to refer to the information that's sent if you own shares in a mutual fund, or, shares in IBM. You may not read much of it, or sometimes not any of it, but it's good to know it's there. You might get a little worried if one year the annual report didn't arrive and you looked in the paper and couldn't find the stock listed anymore.

There are, of course, always going to be costs to provide information, but other institutions have learned to accept this and even welcome it. Some day I hope the pension community will learn this lesson. In fact, if they were ever to get what they want in this area, it would probably spell the end of the private pension system.

With regard to the summary annual report and posting. The cost savings from this are miniscule. As you heard Mr. Harris from the Small Business Council say it's "no big deal" to run off 10 copies of a one-page form. And, since producing the SAR simple involves transposing about eleven numbers from the Form 5500, abolishing it wouldn't save money either.

Congressman Erlenborn's statement that "employees don't want to know all the technical information in the SAR" is counter to the results of the only national poll ever conducted on this subject. I'm including a copy of that poll conducted by Louis Harris and Associates, Inc. for the record.*

Section 3211 of the bill would delete information about so-called 3% transactions from the Form 5500. You might be interested to know that in cases like Grumman where the pension plan is buying up large quantities of company stock but is still below the 10% of assets limitation, this requirement provides the only details on those transactions.

The provision in Section 3211 to delete insurance information is particularly unconscionable. Insurance frauds and excessive insurance commissions are among the most notorious of the schemes by which participants in pension plans are bilked. The provision in §3211 to allow the Secretary of Labor to continue to require the information for types of plans where abuses are likely to occur would not provide sufficient protection: reputations for abuse are built after the fact.

Section 3209 of the bill would deny participants clear statements about the size of benefits they can expect. I am submitting for the record the type of benefit statement employees will get if the law provides (as amended §105(a)(3) would) that anything goes as long as the information is contained somewhere in

Among employees who read their most recent pension report, substantial majorities believe it is "very important" that they receive information about the current financial status of their plan (83%), where pension funds are being invested (60%), who is managing pension funds (60%), and the return on investment (59%). However, among business leaders, just 38% feel it is "very important" that the report contain information about the current financial status of the plan, and less than 20% believe it is important to include information about who is managing the funds, where the funds are invested, and the return on investment. *Harris Poll-February 1979* statements about the size of benefits they can expect. I am submitting for the record the type of benefit statement employees will get if the law provides (as amended §105(a)(3) would) that anything goes as long as the information is contained somewhere in a statement given the individual. As you can see this statement with the lions highlights "projected" benefits. Down at the bottom if you look real close you'll see what's vested -- nothing.

A problem I want to mention and ask for your help on immediately is §105(d) of current law, which is repeated in the bill. This says that subsection (a) of §105 of ERISA, the section requiring benefit statements, shall apply to multiemployer plans "only to the extent provided in regulations." Seven years after ERISA was enacted, there are no regulations. As recounted by Bob McGinnis in testimony before the House Select Committee on Aging last Wednesday, multiemployer plans, like his Teamsters Local 710, are refusing to give out benefit statements, saying they are not required to as long as there are no regulations. Mr. McGinnis as a consequence cannot find out whether the plan's records show that he is entitled to a benefit, nor can he find out how much his benefit, if any, will be.

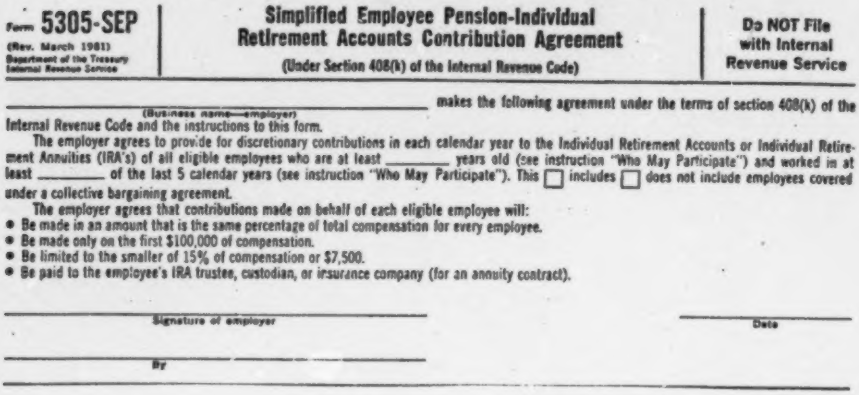
Section 3206 would extend the period between updates of plan descriptions participants are given from every 5 to every 10 years. This is too long to delay telling people about important changes in their plans. Section 3206 of the bill would, moreover, eliminate distribution of inserts for the SPDs detailing changes that have been made in the terms of the plan. Denying participants information about the terms of their own plans as a "cost" measure turns the world upside down. The plans are supposed to be for the participants.

We are not scheduled to testify on Thursday, so with your permission I will offer brief comment on the insurance provision. Section 6104 of the bill would subvert the federal pension insurance program. The insurance guarantee is always subject to change by Congressional action, but to make it subject to change by Congressional inaction, as this section would, completely undermines participant confidence in the program.

Although the fiduciary provisins are not the subject of today's hearing, I think it is important to note that while the prohibited transaction provisions may have stopped one or two good deals, they have also stopped a great many more abuses. Providing government scrutiny of transactions with defined "parties-in-interest" before the fact provides a readily enforceable means of safeguarding plan assets. We have all heard in recent weeks about the weaknesses in the Department of Labor's enforcement effort. Enforcing the "arm's length" standard would be impossible. An "arms length" test as in §3505 amounts to a self-certification by plan trustees that the terms of a transaction are reasonable. It is much easier to fudge on the terms, than it is to hide who the transaction was with. The Department of Labor would need thousands of investigators to enforce this and you could expect abuses to multiply very shortly. With money unavailable except at high interest rates and more and more people realizing how inadequately pension funds are protected it would be extremely imprudent to do anything to weaken enforceability of the fiduciary provisions.

In conclusion, let me say that the public's confidence in having income for retirement has been shaken severely by the social security proposals. Unfortunately, this legislation would shake that confidence further by making prospects for getting pension benefits bleaker than they are even today.

IRS FORM 5305-SEP, SIMPLIFIED EMPLOYEE PENSION-INDIVIDUAL RETIREMENT ACCOUNTS CONTRIBUTION AGREEMENT



Form **5305-SEP**
(Rev. March 1981)
Department of the Treasury
Internal Revenue Service

Simplified Employee Pension-Individual Retirement Accounts Contribution Agreement
(Under Section 408(k) of the Internal Revenue Code)

Do NOT File with Internal Revenue Service

______________________________ makes the following agreement under the terms of section 408(k) of the
(Business name—employer)
Internal Revenue Code and the instructions to this form.

The employer agrees to provide for discretionary contributions in each calendar year to the Individual Retirement Accounts or Individual Retirement Annuities (IRA's) of all eligible employees who are at least ________ years old (see instruction "Who May Participate") and worked in at least ________ of the last 5 calendar years (see instruction "Who May Participate"). This ☐ includes ☐ does not include employees covered under a collective bargaining agreement.

The employer agrees that contributions made on behalf of each eligible employee will:

- Be made in an amount that is the same percentage of total compensation for every employee.
- Be made only on the first $100,000 of compensation.
- Be limited to the smaller of 15% of compensation or $7,500.
- Be paid to the employee's IRA trustee, custodian, or insurance company (for an annuity contract).

____
Signature of employer

____
Date

____
By

SUMMARY ANNUAL REPORT FOR THE UNITED STATES STEEL CORPORATION PLAN FOR EMPLOYEE PENSION BENEFITS (REVISION OF 1950), AS AMENDED

This is a Summary of the Annual Report for United States Steel Corporation Plan for Employee Pension Benefits (Revision of 1950), As Amended, Employer Identification No. 25-0996816 for the year ended December 31, 1980. The annual report has been filed with the Internal Revenue Service, as required under the Employee Retirement Income Security Act of 1974 (ERISA).

Basic Financial Statement

Benefits under the plan are provided by a defined benefit plan. Plan expenses were $459,150,743 for benefits paid to participants and beneficiaries; however, all administrative expenses of the plan were paid directly by the Employer. A total of 225,900 persons were participants in or beneficiaries of the plan at the end of the plan year, although not all of these persons had yet earned the right to receive benefits.

The value of plan assets, after subtracting liabilities of the plan, was $5,786,539,127 as of December 31, 1980, compared to $4,865,704,367 as of January 1, 1980. During the plan year the plan experienced an increase in its net assets of $920,834,760. This increase included unrealized appreciation or depreciation in the value of plan assets; that is, the difference between the value of the plan's assets at the end of the year and the price the plan originally paid for those assets. The plan had total income of $659,458,039, including employer contributions of $257,353,802, employee contributions of $10,466,494, gains of $71,184,024 from the sale of assets, and earnings from investments of $320,453,719.

Minimum Funding Standards

An actuary's statement shows that enough money was contributed to the plan to keep it funded in accordance with the minimum funding standards of ERISA.

Your Rights To Additional Information

You have the right to receive a copy of the full annual report, or any part thereof, on request. The items listed below are included in that report:

1. An accountant's report;
2. Assets held for investment; and
3. Actuarial information regarding the funding of the plan.

To obtain a copy of the full annual report, or any part thereof, write or call the office of United States Steel and Carnegie Pension Fund, the plan administrator, 600 Grant Street, Room 2206, Pittsburgh, PA 15230, Telephone No. (412) 433-4856. The charge to cover copying costs will be $5.60 for the full annual report, or $0.10 per page for any part thereof.

You also have the right to receive from the plan administrator, on request and at no charge, a statement of the assets and liabilities of the plan and accompanying notes, or a statement of income and expenses of the plan and accompanying notes, or both. If you request a copy of the full annual report from the plan administrator, these two statements and accompanying notes will be included as part of that report. The charge to cover copying costs given above does not include a charge for the copying of these portions of the report because these portions are furnished without charge.

You also have the legally protected right to examine the annual report between the hours of 9:00 a.m. and 4:00 p.m., Monday through Friday, in the office of the administrator, United States Steel and Carnegie Pension Fund, 600 Grant Street, 22nd Floor, Pittsburgh, PA 15230 and at the U. S. Department of Labor in Washington, D.C., or to obtain a copy from the U. S. Department of Labor upon payment of copying costs. Requests to the Department should be addressed to: Public Disclosure Room, N4677, Pension and Welfare Benefit Programs, Department of Labor, 200 Constitution Avenue, N.W., Washington, D.C. 20216.

United States Steel And Carnegie Pension Fund
Trustee And Administrator

SAR-P-80

Senator **Nickles**. Mr. Hacking, a couple of questions. And I might ask this question to everybody, but right now, I will just ask it directly to you.

You expressed some concern over the amount of information available to participants under S. 1541. How detailed do you think the reports should be to participants?

Mr. **Hacking**. I think the information needs to be as detailed as necessary to convey meaningful information. The last panel offered testimony to the effect that 2 percent of the participants actually read the annual financial report. Well, obviously, that is a relatively small number of people. They also offered testimony to the effect that much of the information conveyed is not very meaningful or very helpful to people. It seems to me that if only 2 percent are reading the information, and it is not very meaningful to begin with, then the question ought to be what changes need to be made to make that information meaningful to the participants and beneficiaries of the plan. When a person gets old and detached from the work group, he becomes increasingly insecure as to his financial support. This kind of information, received periodically, can be viewed as a lifeline—as something he can rely on, that is going to be there.

Senator **Nickles**. Do you have some suggestions as to what type of information would be meaningful so if we do have a summary annual report or whatever type of report that we did put out to participants and to retirees or both, of what would really be helpful to those individuals so we would come up—if we have a report—with one that would be useful?

Mr. **Hacking**. Let me take counsel with my colleagues and provide you with a response for the record.

Senator **Nickles**. I would very much appreciate that, because it is certainly not my intent nor anybody else's intent, I think, to have reports that are not able to be of help to those people.

Mr. **Hacking**. I would just say, Senator, that obviously, a balance needs to be struck. We are not looking to kill the goose that lays the golden egg, so to speak, by imposing unduly burdensome paperwork requirements on employers and plans. However, you have to understand what happens to people once they become separated from employment. They are out there, relatively isolated; they are becoming old; they are becoming infirm; and they need to know that the income that they rely on is going to continue to be there.

Senator **Nickles**. Ms. Wilson, a couple of questions. I am trying to think back over your testimony. We were setting up to actually make it possible for lump sum. Were you in agreement with the lump-sum provision?

Ms. **Wilson**. No, Senator, and I will elaborate a little better on that.

Senator **Nickles**. You were opposed to it. OK, go ahead.

Ms. **Wilson**. First, there is no guarantee that a lump-sum payment will provide an income throughout a surviving spouse's entire lifetime, and it is especially true in a time of economic uncertainty when it is impossible to predict future inflation rates or increases in the cost of living. We just feel that the advantage of joint and survivor annuity is obvious. It provides a guaranteed income throughout the life of the survivor.

Senator NICKLES. Did I miss the last half of that? Where we were coming from with the idea of the lump sum was primarily as an alternative; you could take a lump sum and purchase a joint survivor, for that matter. You are talking about actuarial equivalents. It would seem to me the more options, the better for that particular person who is going to have the income. You could have a person whose health is failing and maybe has no dependents that they want to leave the money to; they may want to spend the money for whatever purposes; they may want to settle up their estate and get it in good shape—no telling. Or, they may be very young at heart and they may say, "I am going to beat the actuarial tables, and I can live a lot longer than the dates, and so I want a straight life," or joint survivor, or whatever it would be.

Ms. WILSON. Perhaps, Senator. But I guess we feel that permitting the substitution of a death benefit or a lump-sum payment may encourage plans to drop life insurance coverage of employees because of the similarity in the form of payment. But we do agree, it is an alternative.

Senator NICKLES. You also mentioned substituting now a pending bill for what we have in section 3310. But am I correct that you like the thrust of where we are coming as far as preserving the States rights in settlements, but your suggestions is that we and our staff take a look at this pending bill as possibly a better alternative.

Ms. WILSON. Absolutely, Senator.

Senator NICKLES. But you do want to preserve the States rights in those decisions.

Ms. WILSON. Yes, we support the concept. And I guess we just feel that the growing poverty of older American women is a national disgrace, and we think that the subcommittee should direct itself to this problem, and we think significant pension is needed to begin to address this problem, and we feel that the provisions in the Economic Equity Act do begin to address the problem.

Senator NICKLES. You also mentioned, I think, some not necessarily criticism against the 4/40 safe harbor—but the fact that you felt like a great number of women would not qualify because they would not have the 4 years of service. You have several different qualifications—4/40 is one. But you were not wanting 4/40 to be a safe harbor. Are you afraid too many employers would take a 4/40 option?

Ms. WILSON. Well, I guess we just feel that hundreds of thousands of women who are receptionists, nurses, secretaries, technicians, would suffer if this was adopted.

Karen, do you want to elaborate on that?

Ms. FERGUSON. No; that is fine.

Ms. WILSON. The experience shows there are groups of women who suffer under the 4/40 schedule.

Senator NICKLES. But 4/40 would be certainly preferable, in your opinion, to, say, the full vesting at the end of 10 years, with zero vesting up to 10?

Ms. WILSON. Yes.

Senator NICKLES. So that is an option now, and there is another—I am just trying to compare this to others that are in the law today, and I do not see it as really being that much more discriminatory. It would seem where you are coming from, with the short-term employee trying to get earlier vesting, you would probably prefer to have 100 percent vesting the day you walk in the door.

Ms. **Wilson**. If you will familiarize yourself with the provisions of the Economic Equity Act, that is exactly what they speak of.

Ms. **Bross**. I think our concern is establishing that as a safe harbor, not that the law would require anything earlier, but to say that that is off limits and that a real, deliberate pattern would have to evolve over time before the IRS could investigate further to see if discrimination is taking place. We worked with this issue last year when the IRS proposed some regulations, and I would refer you to an editorial by the Washington Post from last July that speaks to that issue.

Senator **Nickles**. To take it a little further, you are afraid of it being a safe harbor, that some people would automatically be qualified, and they could not be contested, I guess, for discrimination. But do you also realize here again, trying to attain our overall goal of more pensions in the private sector for more people, that the safe harbor provision is liable to open it up to where a lot of employers may say, "Yes, now I can get a plan qualified with this provision and enact it without maybe a lot of hassle"?

Ms. **Bross**. There are other options, too. I believe under the Keogh plan, it is a 3-year vesting schedule.

Senator **Nickles**. I am thinking not so much self-employed as an employer with a lot of people that may have a lot of people in the faster rollover portion, male or female, who may come into employment and exit early. I just wanted to feel where your opposition or where your comments were. We are trying to come up with a piece of legislation, I think, that is fair to all concerned, and trying to broaden the base of private pensions.

Mr. Hacking, just one question that comes to mind. You said you felt that part of this legislation might be discriminatory to older Americans. Did I hear that right?

Mr. **Hacking**. Senator, I think you are referring to that portion of our statement where we were talking about suspension of benefits because of reemployment. That provision in our view is discriminatory with respect to older workers. Our concern is this. We have the baby boom population currently in the work force. The population is clearly aging. Public policy, it seems to us, should begin to shift and begin to eliminate those things that currently discourage older workers from continuing to work. The shift should be in the direction of encouraging the retention of older workers in the work force. This appears absolutely essential if we are going to accommodate the demographic change that is taking place.

Senator **Nickles**. Let me just assure you that nothing in this legislation that we are trying to put out would discourage persons from working beyond the age of retirement. I think some of the changes that we have made on the later dates for IRA withdrawals, giving the individual that option, and others, will substantiate the general thrust of our legislation is really to improve the opportunities for those persons who are nearing retirement and beyond retirement, postretirement and preretirement, both. I do not necessarily quite agree with you. I think what you are referring to is under the multiemployer plan where an individual would, say, take retirement and then come back to work for a different employer, and it would provide for suspension of benefits during that period of time of reemployment.

Mr. HACKING. I think the suspension would go beyond just the month in which the individual was actually working and earning. I think that a hard look needs to be taken at section 3302. From our reading of it, that section would indeed discriminate against older workers who have to or want to come back into the job market. It does so by penalizing them with respect to their private pension benefits.

Senator NICKLES. Ms. Ferguson of the Pension Rights Center, we got from the thrust of your statement and also the statement of Mr. Bruce, that you are not really favorable of this piece of legislation. Is there anything that you see in S. 1541 that would be advantageous?

Ms. FERGUSON. Yes, I think there are a couple of provisions, with substantial modifications, that could be very, very helpful. We strongly support the single agency concept, not so much from the point of the employers, although we understand the problems that they have in going from agency to agency and getting conflicting rulings. We see the problem from the point of view of the participant who needs help with a specific pension problem. An individual is told to go to the Labor Department. The Labor Department tells the person to go to the IRS. The IRS sends him back to the Labor Department, and then the Labor Department tells him there is nothing that can be done.

We have three agencies with conflicting mandates. None of them have a mandate to protect participants and beneficiaries. We think that a single agency is essential, but it must have that mandate—if you want to call it the Securities and Exchange Commission of the pension world—the single agency must have that kind of mandate to protect participants.

Another provision that I think is very good—I am not quite sure why it is needed, but nonetheless, I commend it—is the study of master prototype plans. Quite frankly, I do not know why more small employers are not taking advantage of existing master prototype plans. These plans relieve them, effectively, of most worries. The law could be changed, or the regulations could be changed, to go the next degree, so the actual disclosure, the papers, could be filed by the master trustee. But certainly, this is the way that we should go. We should certainly be exploring why it is that the small employers, who would benefit so much from these kind of arrangements, are not using them.

We also think that the simplified employee plan concept is a terribly important one, which most small employers simply do not know about, and I think perhaps the subcommittee might want to explore why it is that small employers are not being told about the kind of plans that would serve their interests as employers and their employees' interests, as well, without all of these excessive costs—and they are excessive for a very small employer.

Senator NICKLES. Under the simplified employee plan, how many of ERISA's reporting and disclosure requirements still apply?

Ms. **Ferguson**. Virtually none. As we understand it, the employer fills out one little form—it is about a quarter of a page or a third of a page form—and that is essentially it. What happens is that the employer is setting up IRA's for his employees. The money belongs to the employees. The financial institution provides the disclosure. It is a very simple arrangement. The employer can do very well for himself or herself, at virtually no cost at all.

Senator **Nickles**. What type of information do you believe should be given to employees annually? Assume that they are given the summary plan description upon entrance into the plan, or employment, or whatever, what type of annual information—the summary annual report exactly as it is today, or do you think we can modify that or improve that to give the individuals some information they can use, and maybe we can increase the 2 percent.

Ms. **Ferguson**. Well, quite frankly, in the Harris poll that we cite in our testimony, it points out that it is closer to 70 or 80 percent of the people who actually are concerned with this information and read it. Perhaps the subcommittee would want to do its own empirical study, but I think you will find that there is great interest in this. There is interest on the part of retirees, because they know very well that if the plan does particularly well, if there is very high return on investment, there is a good chance—not a certainty—but there is a good chance that the employer may voluntarily increase their benefits; they will get ad hoc cost-of-living adjustments. You hear daily, practically, in the newspaper about moneys being stolen, being misused, and employees are very concerned about this.

In the current SAR, we have what is essentially a one-page form—actually, only a half page of text. It is all meaningful information. It should be written in language that is a little simpler, a little easier to understand, and certainly, if it is going to serve the function of a trigger of alerting people to possible, excessive administrative costs, possible bad investments, then it ought to clearly state not just that there are party-in-interest transactions, but that this plan has engaged in transactions with people who have close ties with it in a specified amount, and it ought to say that right in the SAR. And there ought to also be—and perhaps this would be the most important aspect of a revised SAR—which could be done administrative—is for the SAR to clearly state at the top that, "This is a statement of how your pension fund money is being invested, and you have reason to be concerned about how and where your money is being invested." Obviously, the language would be different, but that is the concept. If that concept would be put right across the top of the SAR, it would become a very meaningful document.

Senator **Nickles**. Do you feel that the annual report, the 5500, could be simplified—we had an earlier witness who showed that the annual report was this thick, and it showed all the previous——

Ms. **Ferguson**. Mr. Chairman, I think it can. In fact, our group is about to embark on a major study of ways of helping participants understand their form 5500's, leading them through these forms. In the course of that study, we are going to be working with accountants and actuaries and investment managers, and we are going to be looking to what information in that form is superfluous, and what information is not there. Certainly, this form needs to be looked at and looked at carefully.

Senator NICKLES. I appreciate your interest in that area. Do you think it would be possible, as suggested by some of the earlier panelists, to come up with a simplified annual report form that would be filed with either the benefit administration or DOL, that would be simple enough to where you could just take a copy of that and give it to the employees?

Ms. FERGUSON. I quite frankly do not think so. I think you need the two stages. I think you need the very simple form, which is really the alerting factor, that this is your money, there may be something where the fees here are excessive, the rate of return is terrible—and then I think that those people—and it will always be a handful; any time you are dealing with anything like this, it is the few concerned people who make the difference, who make the system work. And you have to have the detailed disclosure. For example, one of the things that makes many of these forms very fat is that there is a schedule of assets showing where the plan money is invested. That is terribly important. It is the most important information in the form.

Senator NICKLES. Just to get a better idea of how much information you think should be divulged, do you think it is necessary to list every single stock, every single bond, every single real estate venture, original purchasers, market value, et cetera—or maybe, as I think somebody suggested, somewhat consolidating that into percentage of bonds, percentage of stocks, percentage of real estate, and so on?

Ms. FERGUSON. Stephen wants to say something, and so do some of the others, but let me just say I think it is vitally important that that information be at the plan office and available to participants upon request and that it be in Washington, for the Government to be able to take a look and see what is happening there.

Senator NICKLES. So you do think it should be sent to Washington.

Ms. FERGUSON. Yes.

Senator NICKLES. I do not have any problem with having it available for people who may discover some irregularity and they want to see, "Why did we lose so much?" and then somebody would have to explain,

> Well, we invested 35 percent in long-term bonds, and they have taken a bath, so we have had a negative rate of return here, and we have had a positive here, so the net came out very low in a year that somebody might think would be much higher.

I can see some positive things from that. But I somewhat question the idea of having every transaction, major transaction, submitted to DOL, to sit in a room that we could not afford to process or examine even if we had the time and the money to do so.

Ms. FERGUSON. Well, I think, in fact, what you will find, if you talk with the Labor Department officials, is that their regional offices have people working daily, looking through these forms for abuses, targeting actual misuse of funds. The real problem with the Labor Department's enforcement effort is that they are looking only at the very largest plans. They have guidelines that say that they will look only at plans with more than a thousand participants and with more than $1 million in assets. So you are effectively giving carte blanche to all of the many, many other plans which are not being scrutinized by the Labor Department. But I think what you have here is, in the law, Congress determined that it was all right to leave pension money, millions and millions and millions of dollars of pension money, in very close control of people who could be very tempted to use that money for their own purposes, rather than for the purposes of the people whose money it is. And the only restriction that Congress imposed on this were the fiduciary standards, together with disclosure. That is the only limitation. Now, if you take the Labor Department and the IRS out of their monitoring roles, then you are opening the whole system to abuse, and eventually, what you will have to come to is taking this money away from the employers. You cannot leave it in the control of employers and unions with that kind of temptation, without having some kind of Government scrutiny, as well as the participants' scrutiny—they work together—in monitoring the investment of these funds.

Senator NICKLES. I almost have to agree—but you have the employee's entire wages under the control of the employer——

Ms. FERGUSON. Wages go directly to the employee, and he gets those immediately. What you are talking about here is money that is pooled, that is invested, that is sitting there, and very, very attractive to use for corporate expansion; it could be used to buy your own swimming pool—for all sorts of purposes. And the theory of the law, which I think is a very solid one, is that——

Senator NICKLES. Is it legal under the law to buy your own swimming pool?

Ms. FERGUSON. No. But who is going to find out if you do not have some kind of disclosure?

Senator NICKLES. Mr. Bruce, did you have a comment?

Mr. BRUCE. In the United States Steel plan, for example, the annual report, which I just received recently, was 61 pages, and that plan has over $5 billion in assets. The assets in that plan are comparable to what United States Steel as a company is worth. I do not see how we can have pools of that kind of money sitting around without any sort of Government regulation. We would not propose it for the banks. We would not propose it for mutual funds. But somehow, we can propose it for pension funds. It is a second-class status that just will not work.

Senator NICKLES. I have no further questions. I would like to advise all of the panelists today that we are going to be keeping the record open, and I think it is possible that myself or other members of the subcommittee may submit additional questions to you for your input.

I will repeat again that we will have hearings this Thursday on title VI of this bill, title IV of ERISA, the insurance provisions, and that also, we will have the prohibited transactions on January 26, for those who are interested in that part of the bill.

The meeting is adjourned.

[Whereupon, at 12:20 p.m., the subcommittee was adjourned.]

RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE SIMPLIFICATION ACT OF 1981

THURSDAY, NOVEMBER 12, 1981

U.S. SENATE,
SUBCOMMITTEE ON LABOR OF THE
COMMITTEE ON LABOR AND HUMAN RESOURCES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:40 a.m., in room 4232, Dirksen Senate Office Building, Senator Don Nickles (chairman of the subcommittee) presiding.

Present: Senator Nickles.

Senator NICKLES. Good morning.

Today is the third day of hearings on S. 1541.

Our focus this morning will be on title VI of the bill, which pertains primarily to title IV of ERISA, the single employer termination insurance amendment.

Several major or significant amendments included in title VI are changing the insurable event from termination at will, increasing the liability from 30 percent to 100 percent, changing the creditor status from that of a tax lien into a general creditor status, and also imposing some contingent liabilities to stop some rollovers and rollover liabilities to PBGC.

Our first witness this morning is Dr. William Niskanen, and Bob Nagle, Executive Director of the PBGC with him.

Gentlemen, we welcome you and look forward to your input and expertise on this legislation.

STATEMENT OF DR. WILLIAM A. NISKANEN, MEMBER, PRESIDENT'S COUNCIL OF ECONOMIC ADVISERS, WASHINGTON, D.C., ACCOMPANIED BY ROBERT NAGLE, EXECUTIVE DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION

Dr. NISKANEN. I am here as Chairman of the Pension Policy Working Group of the Cabinet Council on Economic Affairs.

The Cabinet Council has authorized me to present the administration's position on certain aspects of S. 1541, a bill to amend the Employee Retirement Security Act [ERISA]. With me is Mr. Robert Nagle, Executive Director of the Pension Benefit Guaranty Corporation.

My remarks today will be limited to the provisions of title VI of S. 1541 that deal with termination insurance for single employer pension plans. I will have nothing to say on the many other changes to ERISA proposed in that bill, including the proposed changes in tax law concerning funding at time of plan termination.

Under current law, the Pension Benefit Guaranty Corporation [PBGC], wholly owned by the U.S. Government, protects participants in private pension plans against loss of certain benefits if their plans are terminated. The insurance program covers about 25 million participants in defined benefit single employer plans and 8 million participants in multiemployer plans. Every year, thousands of covered pension plans are terminated. Firms may terminate plans because they no longer wish to have a defined benefit pension plan, or because they are liquidating their operations. The overwhelming majority of terminated pension plans are fully funded. Only a small percent have assets that are insufficient to cover benefits promised to the firm's workers. It is these plans that sometimes become a drain on the PBGC's resources.

The PBGC is financed by mandatory insurance premiums. For single employer plans, the annual premium is $2.60 per participant. In fiscal year 1980, the PBGC collected $71 million in premiums from single employer pension plans, and earned another $22 million in investment income on assets of over $300 million. Its long-term liabilities, mostly pension benefits due workers in the future, currently exceed its assets by over $100 million.

There are two serious problems in ERISA's treatment of termination insurance for single employer pension plans. Both problems may allow solvent firms to pass the cost of benefits promised to their workers on to the PBGC, and ultimately on to other premium payers.

The first problem is that termination of the pension plan rather than liquidation of the firm is the insurable event. This provision of ERISA, together with the limitation on PBGC's claim on the firm's assets, may result in large, unintended increases in PBGC liabilities.

Under current law, if a pension plan terminates without enough assets to pay the benefits guaranteed under ERISA, the PBGC becomes responsible for paying those benefits. PBGC can then claim up to 30 percent of the sponsoring firm's net worth. Since plan termination is voluntary under title IV of ERISA, this rule allows firms to pass any unfunded pension liabilities in excess of 30 percent of their companies' net worth on to the PBGC.

Most terminations of inadequately funded plans have occurred because the employers confronted severe financial difficulties, resulting in bankruptcy proceedings. Recently, however, some ongoing firms with low net worth have recognized that they may be able to terminate their pension plans for a far lower cost, 30 percent of their low net worth than the value of the unfunded liabilities. Also, some prosperous firms have spun off weak subsidiaries and their unfunded pension liabilities in an attempt to remove the parent companies' assets from the PBGC's reach when the subsidiaries subsequently terminate their pension plans.

Under a variety of financial circumstances, current law encourages employers to terminate their plans and to leave other premium payers to absorb the balance of their unfunded pension obligations. The firm's workers would lose little if the PBGC were to recognize the termination when the employer establishes a new similar plan with past service credit.

In two recent cases, employers have attempted to terminate their plans and immediately set up new plans paying similar benefits with the exception of an offset for the benefits payable by the PBGC under the terminated plan. Although the PBGC has taken the position that such action is not consistent with the law, some employers believe that dumping their pension liabilities on the insurance system may constitute a sound business decision. The resulting pressure on PBGC premium levels may soon become evident; congressional clarification is needed.

The PBGC has identified 30 major firms with unfunded pension benefits each of $10 million or more that are under financial pressure and for which payments of 30 percent of net worth could prove an attractive alternative to the continued funding of their plans. If all these firms were to terminate their plans, the PBGC would suffer an estimated $3.8 billion in losses. Even if only a small percentage of these terminations occur, PBGC would suffer a serious strain on its resources, and a substantial premium increase would become necessary.

S. 1541 would prevent ongoing firms from dumping their unfunded pension liabilities onto the PBGC by changing the insurable event from plan termination to the liquidation of the sponsoring firm. With this change, employers would no longer be able to continue in business while trading 30 percent of their net worth in exchange for PBGC's assumption of their unfunded pension liabilities. S. 1541 would also eliminate the limitation on PBGC's claim to 30 percent of the employer's net worth in order to improve the soundness of ERISA's termination insurance program and to protect its premium payers. The administration supports this change in the insurable event from plan termination to employer liquidation.

An additional change proposed in S. 1541 would lower PBGC's claim on a firm's assets from preferred to general creditor status. Preferred creditor status is necessary under current law, because PBGC's claim is limited to 30 percent of net worth. Because the exact value of net worth is often a subject of dispute in bankruptcy proceedings, and because its determination is usually the result of negotiations among the various participants, a priority claim against net worth provides the PBGC with considerable power at the bargaining table. This leverage in bankruptcy negotiations has enabled the PBGC to recover substantial amounts from companies undergoing reorganization.

With the elimination of the 30-percent limitation, the PBGC no longer needs preferred creditor status. S. 1541 therefore provides the PBGC with the same status as other general unsecured creditors. The administration supports general creditor status for the PBGC, and opposes the suggestion made by some that PBGC claims be subordinated to those of other unsecured creditors. Pension plans provide employee benefits that were agreed to by the firm. The obligations arising from pension plans should receive the same treatment in bankruptcy as other unsecured obligations. Without at least general creditor status, the PBGC would rarely obtain even partial recovery in bankruptcies. Subordinated status would restrict PBGC recovery to those rare bankruptcy proceedings in which all general creditors are paid in full, and would increase PBGC insurance premiums.

General creditor status for the PBGC, along with elimination of the 30-percent limitation, would provide a fair claim on the bankrupt estate and would insure adequate protection for the termination insurance system.

The administration also supports this change in the creditor status of the PBGC. Consideration should be given to making these two changes effective 1 year after passage of this legislation, in order to avoid disruption of credit negotiations that are underway.

The second important problem with the single employer termination insurance provisions of ERISA concerns the transfer of plans.

Under current law, if a pension plan is terminated shortly after a business has been sold, the owner before the sale may not be liable to the PBGC even though he was the employer over most of the period during which the pension liabilities accrued. This sometimes allows a business to shed unfunded pension liabilities by spinning off or selling weak subsidiaries or divisions. The PBGC then becomes liable once the sold or spunoff unit becomes insolvent.

To date, 21 percent of PBGC's losses, totaling $48 million, have occurred in cases where companies have sold or spun off weak subsidiaries or divisions, and the subsidiary's pension plan has subsequently been terminated. Although it is difficult to predict future trends, the risk to the termination insurance program could be very large. In 1980, the reported unfunded vested liabilities of the pension plans of publicly traded firms exceeded $19.3 billion. If only a small percentage of sponsoring firms tried to shed these liabilities, the burden on the PBGC and on other premium payers could be enormous.

At this point, let me interject to put this figure in context. The unfunded liabilities of $19.3 billion bulk are very large relative to the reserves of PBGC, but should not be interpreted as an indication that most private pension plans are in trouble. The unfunded liabilities of private pension funds are quite small, relative to the assets and continuing profits of firms, and most private pension plans are in very good shape. The $19.3 billion of unfunded liabilities, for example, represents only about 10 percent of pretax corporate taxes in 1980.

S. 1541 would correct this problem. The bill provides, with certain exceptions, that if a business with unfunded pension liabilities is sold, the seller can be held liable to the PBGC if the pension plan is terminated within 15 years after the sale. Contingent liability would apply to transfers of divisions and subsidiaries. The bill contains exceptions to contingent liability when the seller can show that (1) the net tangible assets of the purchaser exceed either the net tangible assets of the seller or the unfunded benefits under the plan or (2) there are fewer than 35 participants in the plan.

My expectation is that most transfers would qualify under one of these two exceptions.

S. 1541 also imposes contingent liability on firms within the same business control group as the seller. The bill provides that any firm within the same affiliated group as the seller within 5 years prior to a sale could be liable to the PBGC if a pension plan is terminated within 15 years after the sale. Thus, business cannot evade liability by leaving the controlled group shortly before its affiliate is sold or spun off.

The administration supports this contingent liability as defined in S. 1541. Contingent liability of sellers and their affiliated companies will make it difficult for a company to structure a sale or spinoff simply in order to shift its pension responsibilities to the PBGC. A 15-year contingent liability period—as compared to a shorter interval—minimizes the possibility that a company will temporarily subsidize its divested affiliate in order to avoid transfer liability.

The administration believes, however, that a business that is separated from a control group should not be subject to unlimited liability for the plan of another member of the control group. Consideration should be given to limiting the liability of the separated company to its net worth on separation, at any time following 5 years after separation. This rule would protect the insurance system from losses caused by separating out the valuable members of a control group before an insurable event occurs, while at the same time avoiding a continued inequitable burden on the spun-off company. Without the suggested limitation, a small division spun off from a large company would be contingently liable for the full underfunding of its former parent's plan, even though the spin off resulted in little reduction in the worth of the parent.

Although S. 1541 would impose new constraints when pension debt is transferred to a new company, the bill's exceptions will make it easy for firms to avoid contingent liability if they so desire. There are a variety of ways under current law by which firms can sell subsidiaries or divisions without transferring pension debt to the buyer. The new difficulties created by contingent liability for buyers and sellers of businesses, we believe, are minor compared to the improvement in the operation of ERISA's termination insurance program.

One change I would like to suggest is an exemption from contingent liability for all pension plans with unfunded vested liabilities below $500,000. Unfunded liabilities could easily be calculated from actuarial assumptions published annually by the PBGC. This exemption would be a substitute for the exemption in the bill based on the number of plan participants.

An exemption based on the size of unfunded pension liability would protect the PBGC from large losses while eliminating the burden of contingent liability for the many small firms that are sold to new owners each year. Such an exemption would better identify situations in which protection for the termination insurance system is appropriate than the one based on the number of plan participants.

S. 1541 also makes two other changes that would reduce administrative costs of termination insurance both to the PBGC and to plan sponsors. Under the current law, ERISA requires costly and time-consuming intervention whenever an employer terminates a pension plan, even though 98 percent of terminated plans are fully funded. S. 1541 would permit fully-funded terminated pension plans simply to certify that their assets are sufficient to pay benefits. The bill would streamline transaction procedures and consequently lower administrative expenses. The administration supports this change.

S. 1541 also eliminates PBGC administration of terminated pension plans when Federal guarantee payments are not required. Currently, ERISA requires the PBGC to take over the management of all insufficiently funded plans at termination, even where the sponsors are willing and able to complete the funding and administration of the terminated plan. This requirement is unnecessary and adds needless Government interference to a situation which can be handled adequately by plan sponsors and trustees. The administration also supports this change.

Thank you again, Mr. Chairman. for this opportunity to explain the administration's position on changes to termination insurance. We would be glad to answer any questions you might have on this issue.

[The prepared statement of Mr. Niskanen follows:]

FOR RELEASE UPON DELIVERY
NOVEMBER 12, 1981

STATEMENT BY

WILLIAM A. NISKANEN
MEMBER, COUNCIL OF ECONOMIC ADVISERS

BEFORE THE

COMMITTEE ON LABOR AND HUMAN RESOURCES
SUBCOMMITTEE ON LABOR

UNITED STATES SENATE

NOVEMBER 12, 1981

Mr. Chairman and Members of the Subcommittee on Labor. I am here as head of the Pension Policy Working Group of the Cabinet Council on Economic Affairs. The Cabinet Council has authorized me to present the Administration's position on certain aspects of S. 1541, a bill to amend the Employee Retirement Income Security Act (ERISA). With me is Mr. Robert Nagle, Executive Director of the Pension Benefit Guaranty Corporation.

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Proposed Changes in the Insurable Event and in PBGC's Claim in Bankruptcy Proceedings

There are two serious problems in ERISA's treatment of termination insurance for single employer pension plans. Both problems may allow solvent firms to pass the cost of benefits promised to their workers onto the PBGC, and ultimately onto other premium payers.

The first problem is that termination of the pension plan rather than liquidation of the firm is the insurable event. This provision of ERISA, together with the limitation on PBGC's claim on the firm's assets, may result in large, unintended increases in PBGC liabilities.

Under current law, if a pension plan terminates without enough assets to pay the benefits guaranteed under ERISA, the PBGC becomes responsible for paying those benefits. PBGC can then claim up to 30 percent of the sponsoring firm's net worth. Since plan termination is voluntary under Title IV of ERISA, this rule allows firms to pass any unfunded pension liabilities in excess of 30 percent of their companies' net worth onto the PBGC.

Most terminations of inadequately funded plans have occurred because the employers confronted severe financial difficulties, resulting in bankruptcy proceedings. Recently, however, some ongoing firms with low net worth have recognized that they may be able to terminate their pension plans for a far lower cost (30 percent of their low net worth) than the value of the unfunded liabilities. Also, some prosperous firms have spun off weak subsidiaries and their unfunded pension liabilities in an attempt to remove the parent companies' assets from the PBGC's reach when the subsidiaries subsequently terminate their pension plans.

Under a variety of financial circumstances, current law encourages employers to terminate their plans and to leave other premium payers to absorb the balance of their unfunded pension obligations. The firm's workers would lose little if the PBGC were to recognize the termination when the employer establishes a new similar plan with past service credit. In two recent cases, employers have attempted to terminate their plans and immediately set up new plans paying similar benefits with the exception of an offset for the benefits payable by the PBGC under the terminated plan. Although the PBGC has taken the position that such action is not consistent with the law, some employers believe that "dumping" their pension liabilities on the insurance system may constitute a sound business decision. The resulting pressure on PBGC premium levels may soon become evident. Congressional clarification is needed.

The PBGC has identified 30 major firms with unfunded pension benefits each of $10 million or more that are under financial pressure and for which payments of 30 percent of net worth could prove an attractive alternative to the continued funding of their plans. If all these firms were to terminate their plans, the PBGC would suffer an estimated $3.8 billion in losses. Even if only a small percentage of these terminations occur, PBGC would suffer a serious strain on its resources, and a substantial premium increase would become necessary.

S. 1541 would prevent ongoing firms from dumping their unfunded pension liabilities onto the PBGC by changing the insurable event from plan termination to the liquidation of the sponsoring firm. With this change, employers would no longer be able to continue in business while trading 30 percent of their net worth in exchange for PBGC's assumption of their unfunded pension liabilities. S. 1541 would also eliminate the limitation on PBGC's claim to 30 percent of the employer's net worth in order to improve the soundness of ERISA's termination insurance program and to protect its premium payers. The Administration supports this change in the insurable event from plan termination to employer liquidation.

An additional change proposed in S. 1541 would lower PBGC's claim on a firm's assets from preferred to general creditor status. Preferred creditor status is necessary under current law, because PBGC's claim is limited to 30 percent of net worth. Because the exact value of net worth is often a subject of dispute in bankruptcy proceedings, and because its determination is usually the result of negotiations among the various participants, a priority claim against net worth provides the PBGC with considerable power at the bargaining table. This leverage in bankruptcy negotiations has enabled the PBGC to recover substantial amounts from companies undergoing reorganization.

With the elimination of the 30 percent limitation, the PBGC no longer needs preferred creditor status. S. 1541 therefore provides the PBGC with the same status as other general unsecured creditors. The Administration supports general creditor status for the PBGC, and opposes the suggestion made by some that PBGC claims be subordinated to those of other unsecured creditors. Pension plans provide employee benefits that were agreed to by the firm. The obligations arising from pension plans should receive the same treatment in bankruptcy as other unsecured obligations. Without at least general creditor status, the PBGC would rarely obtain even partial recovery in bankruptcies. Subordinated status would restrict PBGC recovery to those rare bankruptcy proceedings in which all general creditors are paid in full, and would increase PBGC insurance premiums.

General creditor status for the PBGC, along with elimination of the 30 percent limitation, would provide a fair claim on the bankrupt estate and would ensure adequate protection for the termination insurance system.

The Administration also supports this change in the creditor status of the PBGC. Consideration should be given to making these two changes effective one year after passage of this legislation, in order to avoid disruption of credit negotiations that are underway.

Contingent Liability

The second important problem with the single employer termination insurance provisions of ERISA concerns the transfer of plans.

Under current law, if a pension plan is terminated shortly after a business has been sold, the owner before the sale may not be liable to the PBGC even though he was the employer over most of the period during which the pension liabilities accrued. This sometimes allows a business to shed unfunded pension liabilities by spinning off or selling weak subsidiaries or divisions. The PBGC then becomes liable once the sold or spun-off unit becomes insolvent.

To date, 21 percent of PBGC's losses, totalling $48 million, have occurred in cases where companies have sold or spun off weak subsidiaries or divisions, and the subsidiary's pension plan has subsequently been terminated. Although it is difficult to predict future trends, the risk to the termination insurance program could be very large. In 1980, the reported unfunded vested liabilities of the pension plans of publicly traded firms exceeded $19.3 billion. If only a small percentage of sponsoring firms tried to shed these liabilities, the burden on the PBGC and on other premium payers could be enormous.

S. 1541 would correct this problem. The bill provides, with certain exceptions, that if a business with unfunded pension liabilities is sold, the seller can be held liable to the PBGC if the pension plan is terminated within 15 years after the sale. Contingent liability would apply to transfers of divisions and subsidiaries. The bill contains exceptions to contingent liability when the seller can show that (1) the net tangible assets of the purchaser exceed either the net tangible assets of the seller or the unfunded benefits under the plan or (2) there are fewer than 35 participants in the plan.

S. 1541 also imposes contingent liability on firms within the same business control group as the seller. The bill provides that any firm within the same affiliated group as the seller within 5 years prior to a sale could be liable to the PBGC if a pension plan is terminated within 15 years after the sale. Thus, business cannot evade liability by leaving the controlled group shortly before its affiliate is sold or spun off.

The Administration supports this contingent liability as defined in S. 1541. Contingent liability of sellers and their affiliated companies will make it difficult for a company to structure a sale or spin-off simply in order to shift its pension responsibilities to the PBGC. A 15-year contingent liability period -- as compared to a shorter interval -- minimizes the possibility that a company will temporarily subsidize its divested affiliate in order to avoid transfer liability.

The Administration believes, however, that a business that is separated from a control group should not be subject to unlimited liability for the plan of another member of the control group. Consideration should be given to limiting the liability of the separated company to its net worth on separation, at any time following five years after separation. This rule would protect the insurance system from losses caused by separating out the valuable members of a control group before an insurable event occurs, while at the same time avoiding a continued inequitable burden on the spun-off company. Without the suggested limitation, a small division spun-off from a large company would be contingently liable for the full underfunding of its former parent's plan, even though the spin-off resulted in little reduction in the worth of the parent.

Although S. 1541 would impose new constraints when pension debt is transferred to a new company, the bill's exceptions will make it easy for firms to avoid contingent liability if they so desire. There are a variety of ways under current law by which firms can sell subsidiaries or divisions without transferring pension debt to the buyer. The new difficulties created by contingent liability for buyers and sellers of businesses are minor compared to the improvement in the operation of ERISA's termination insurance program.

One change I would like to suggest is an exemption from contingent liability for all pension plans with unfunded vested liabilities below $500,000. Unfunded liabilities could easily be calculated from actuarial assumptions published annually by the PBGC. This exemption would be a substitute for the exemption in the bill based on the number of plan participants.

An exemption based on th size of unfunded pension liability would protect the PBGC from large losses while eliminating the burden of contingent liability for the many small firms that are sold to new owners each year. Such an exemption would better identify situations in which protection for the termination insurance system is appropriate than one based on the number of plan participants.

Other Proposed Changes

S. 1541 also makes two other changes that would reduce administrative costs of termination insurance both to the PBGC and to plan sponsors. Under the current law, ERISA requires costly and time-consuming intervention whenever an employer terminates a pension plan, even though 98 percent of terminated plans are fully funded. S. 1541 would permit fully funded terminated pension plans simply to certify that their assets are sufficient to pay benefits. The bill would streamline transaction procedures and consequently lower administrative expenses. The Administration supports this change.

S. 1541 also eliminates PBGC administration of terminated pension plans when Federal guarantee payments are not required. Currently, ERISA requires the PBGC to take over the management of all insufficiently funded plans at termination, even where the sponsors are willing and able to complete the funding and administration of the terminated plan. This requirement is unnecessary and adds needless government interference to a situation which can be handled adequately by plan sponsors and trustees. The Administration also supports this change.

Thank you again, Mr. Chairman and distinguished members of this Subcommittee, for this opportunity to explain the Administration's position on changes to termination insurance. I would be glad to answer any questions you might have on this issue.

Senator NICKLES. Thank you very much, Mr. Niskanen, for your comments, and also for your support for many of the basic changes that we are trying to make in title VI.

I have a couple of questions, either for you or Mr. Nagle, whichever would be appropriate.

Is the current premium that we now have of $2.60 adequate to cover PBGC's statutory obligations?

Mr. NAGLE. I believe it probably is not, Senator. We are presently considering the matter in some detail, and expect to have some recommendations within the next couple of months, while we are presently studying the impact, or assessing our experience for the fiscal year that just ended.

I believe that if legislation of this type is not enacted, why the present premium will be found to be drastically short of what might well be required, if this type of legislation is enacted. I think that any increased premium requirements would be significantly more modest.

As I said, we expect to have some recommendations within the next couple of months.

Senator NICKLES.

Not to tie you down, but even to paraphrase, if we make the changes as suggested—and let me just ask, for the record, are a lot of these changes that we are making in title VI, actually ones our staff and others have been working on with the PBGC, that you have recommended, which need to be made?

Mr. NAGLE. That is correct, Senator, yes.

Senator NICKLES. Are the majority of them?

Mr. NAGLE. Yes.

Senator NICKLES. Even given these changes, we are still looking at a fairly substantial increase in the premium; is that correct?

Mr. NAGLE. I believe there would be some increase needed, even with the changes; yes.

Senator NICKLES. Are you talking about—I guess I am fishing a little bit, and if you do not really want to give these figures for some reason, I will not press for them, but are we looking at the premium doubling in the next year, regardless of whether or not these changes are made?

Mr. NAGLE. I think it could go up to something in that area, but I really prefer to have something more definitive before speculating about it.

Senator NICKLES. That is fine.

If these changes are not made—and I think your words were that the premiums need to be substantially more—in other words, they may even double, if we do make the changes, but if we do not make some of the changes as recommended in here, you will see premiums go up at a much, much more rapid rate?

Mr. NAGLE. That is correct, and that is really hard to project. It is hard to project just what the amount might be, because we are really trying to guess at how great the abuse types of situations might prove to be.

Dr. Niskanen mentioned a figure of potential losses to the corporation of $3.8 billion. That is just looking at the 30 largest companies, with unfunded liabilities of $10 million or more, and just assuming that all of those should attempt to terminate their plans;

that is, of course, just—we really have no way of knowing how many plans might attempt to take advantage of any of the provisions in the statute, as it is now presently written.

Senator NICKLES. There are 30 firms that have unfunded vested liability of $10 million or more?

Mr. NAGLE. That is correct.

Senator NICKLES. With low net worth, it looks like it would be to their possible advantage to utilize the law as it is written today.

Mr. NAGLE. That is correct, Senator.

Senator NICKLES. You also have thousands of smaller firms that you are not talking about, in the tens of millions, but still in the 5 million, 1 million? A quantity of those plans that are possibly viable would see that it is to their economic benefit to have the PBGC assume some of their liabilities.

Mr. NAGLE. That is right.

Senator NICKLES. Are you afraid, possibly, that this will be the result?

Have there been firms that have looked at the law and determined that it is in their economic interest to terminate the plan—they may lose 30 percent of their net assets, maybe their asset ratio at that time was low anyway, to shovel off those unfunded liabilities on to PBGC—and then to continue going on as a viable firm?

Mr. NAGLE. We believe there have been only very, very few so far, but we are afraid that there is something that might catch on.

Senator NICKLES. If other employers, or other companies see that actually happening and they are really having a hard time keeping their head above water—maybe they see a competitor who is able to slough off a large percentage of their pension liabilities on PBGC, and able to continue going on as a firm—then other firms might look at that and say this is maybe something we should try.

Mr. NAGLE. That is what our concern is; yes.

Senator NICKLES. In the period that we are in today, with economic conditions being somewhat difficult on a lot of industries, particularly, major industries like steel and automobiles, but that factors down into the housing, and you have a lot of construction, and so on; do you think that is a possibility?

Mr. NAGLE. Yes; I do. I think if companies are faced with somewhat stringent economic circumstances they are going to be more motivated to look for ways to cut back on their costs, and this may occur to many as one way to do it.

Senator NICKLES. You mentioned, or Dr. Niskanen mentioned that there is a deficit of $100 million in PBGC's funds today; is that correct? A deficit? You actually have a fund value that has how many millions of dollars in it today?

Mr. NAGLE. We have presently about $350 million under investment.

Senator NICKLES. $350 million on the asset side. What do you have then on the present value of your liabilities? $450 million, is that right?

Mr. NAGLE. Probably, right now, it is. We are just calculating the year-end, the figures for the fiscal year that just ended. I imagine it will be our number for guaranteed benefits will be close to $550 million.

Senator NICKLES. $500 million? Let me ask you a question.

I am assuming that most of the payouts that you are making to the employees under PBGC are in the form of annual payouts. What kind of annual output do you have going out, and how much annual income do you have coming in?

Mr. NAGLE. They normally are paid in monthly payments. We are presently paying about $4 million a month in benefits to the participants in plans that are presently under your trusteeship.

Senator NICKLES. What kind of revenues are you receiving from the premiums?

Mr. NAGLE. Well, the—somewhere over $75 million a year.

Senator NICKLES. $75 million. You have a positive cash flow, but you have a situation—tell me how you are in financial straits, then?

Are you looking at some of those liabilities?

Mr. NAGLE. We have a positive cash flow, and expect to have for sometime to come, but when we calculate the present value of the liabilities, we are now responsible for assuming and compare that with our assets. That is how we derive our deficit figure.

Senator NICKLES. That is how a lot of pension plans get into trouble, when they assume they are in good shape, and have a positive cash flow, and do not actually calculate the amount to those unfunded liabilities; correct?

Mr. NAGLE. That is right.

Senator NICKLES. Dr. Niskanen, you mentioned a lot of things that need to be tightened up as far as the PBGC insurance program. Do you feel that this type of legislation, with some modifications, is timely, that we need to look at this, or the problems will continue to exacerbate if we do not move now? I am appreciative of some of the modifications that have been suggested concerning contingent liability along with others and we will certainly take a close look at those.

Dr. NISKANEN. I urge you to move quickly on this, for two reasons. Both to protect the PBGC and, in effect, protect those existing premium payers against a substantial increase in their premiums, as well as to implement those sections of the bill that would substantially reduce the administrative burdens on a lot of small companies, and on most of the terminated plans.

As you know, ERISA is regarded as one of the more irritating of Federal laws, particularly for small business, and I think this bill has the potential of greatly reducing the level of administrative and accounting burden on most business.

Senator NICKLES. It has been suggested, by some, that this legislation is not timely, and it is really not needed any way, because it all can be done by administration.

Would you care to comment on that?

Dr. NISKANEN. I can symphasize with Bob Nagle's position in not wanting to interpret the law very broadly, and I think that it is important to have the change in the law, to make it clear what the intent of Congress is in this regard. A great many of these administrative issues can be handled without change in the law, but any administrator would be risking an interpretation of the law that would not be consistent with the intent of Congress if he used a very broad interpretation.

Senator NICKLES. Let me be more specific then.

Under the law as it states today, insurable event is termination of the plan, which is strictly a wholly voluntary event. We would change that more or less to liquidation of the firm. We are talking about major—major significant play when PBGC would take an active role as far as covering liability of those plans.

I believe, Mr. Nagle, is it not true, that PBGC is now in court over—in some cases, on when that termination would take place? It is actually in the statute? The statute says when a termination plan, and termination is voluntary.

If we are going to make that change, does it not have to be made statutorily, legislatively?

Mr. NAGLE. Yes; I believe it does.

Senator NICKLES. What about the law as it stands right now which limits PBGC's claim against a firm of 30 percent of net assets? If that is going to be changed, it has to be changed statutorily, is that correct?

Mr. NAGLE. Yes; there is nothing we could do.

Senator NICKLES. There is nothing you could do. So under the present law you could have a firm either spinoff, or you could have a firm just decide to set their economic interest to try to terminate the plan, and have PBGC pick up their unfunded vested liabilities, and really have the rest of the industry groups, or the rest of the employers and employees picking up those costs, when in effect they are just taking advantage of the law as it is written today. If we are going to change that loophole or that possibility for abuse, then we are going to have to do it statutorily.

Am I not correct?

Mr. NAGLE. I believe that is correct, Senator.

Senator NICKLES. I think it is an important thing, and I hope people would realize in this room, and others, that my endeavors with this particular legislation is not because I want to play around with ERISA. I really and truly believe that we have very, very serious problems on the horizon with PBGC, and with the entire ERISA philosophy, if some of those loopholes are not changed, particularly in view of the economic climate.

I think there are a lot of persons and companies that will take advantage of the situation.

A couple of other quick questions.

You mentioned the possibility that PBGC was reviewing the premiums, and the need for premiums, in light of existing legislation, or the legislation that we are proposing.

Do you have a time or deadline that we might have your recommendations?

Mr. NAGLE. I would like to complete them within the next couple of months.

Senator NICKLES. Is it necessary for a change in the PBGC premium to be done statutorily?

Mr. NAGLE. Well, it is not by statute. It is by concurrent resolution.

The administration would have to submit the recommendations to the four committees of Congress that have jurisdiction, and it could be approved by concurrent resolution of the Congress.

Senator NICKLES. Dr. Niskanen, you mentioned a couple of exemptions. There is an exemption right now for contingent liability for employers with—or a firm with plans of 35 or less participants.

You mentioned moving that over to only plans that had unfunded vested liabilities greater than $500,000. Is that an easy figure to figure?

Here again, I am trying to think of business's X, Y, Z purchasing another business, and then start worrying about the contingent liabilities factors. Is this a difficult one, and one that could be readily attained?

Dr. NISKANEN. My understanding is, that number could be easily calculated from actuarial assumptions that are published by the PBGC.

Senator NICKLES. Another question.

I do not know if the Administration wrestled with this question. I have personally wrestled with it, the exemption of premiums from firms in the bill as it is now would exempt those firms, those plans with fewer than 35 participants.

Have you examined that question?

Dr. NISKANEN. Yes; but I am not in a position to speak for the administration on that specific issue. One thing that should be generally recognized is that there is a very skewed distribution of participants by firms. The data which we have suggests that 70 percent of the defined benefit plans have fewer than 50 participants. But those 70 percent of the plans have only four percent of the total participants.

So that one could exempt most plans from this contingent liability, without putting any significant burden on the PBGC in terms of the exemption. We do not have the specific data that would be consistent with a $500,000 limit, but my judgment is that it would have the effect of exempting roughly 90 percent of the defined benefit plans, and maybe up to 10 percent of the participants, although that latter number is something that we do not have specific information on.

Senator NICKLES. Dr. Niskanen, you came out basically in favor of moving the 30-percent limitation to 100 percent, and also moving the creditor status from a tax lien status to that of a general creditor.

Many are suggesting that it have the subordinate level, from general creditor status. Do you feel very strongly that we would be possibly leaving PBGC open to much if we had it in a subordinate level?

Dr. NISKANEN. I believe the risk to PBGC would be too large in that respect, in that it would be left with whatever claims, and whatever assets are available, after all unsecured creditors are paid off.

In this regard, I think it is important to recognize some results of a study performed by the pension group in the National Bureau of Economic Research. The study focused on the 200 largest manufacturing firms and, in effect, concluded that the financial markets are acting as if the unfunded vested liabilities are equivalent to debt that are on the books. They are treating footnote debt in much the same way that they are treating a debt that is on the books.

To the extent that that conclusion, which was based upon a sample of the 200 largest manufacturing firms, generalizes to the larger community, it would suggest that a change in the creditor status, from a preferred tax lien on 30 percent of the equity to a general creditor status should not have any effect in the market value of these firms. There should be no identifiable effect in the market value by a change in this status.

Senator NICKLES. Do you feel like it would make it difficult for the majority of firms, small and large, that would change to a general creditor status, and went to the 100-percent liability, to enter into the capital markets?

Dr. NISKANEN. Well, I do not think so, Senator, and the reason for it is that it appears that the financial markets have taken into account this kind of debt in their present evaluations of these firms, and that it does not change the effective financial status of the firm.

Whether or not it changes its formal liabilities, the market appears to have taken into account this vested liability, as if it were booked debt.

Senator NICKLES. Gentlemen, I have no further questions. I am sure that I will have additional questions, not only on title VI, but on the other titles of the bill, as we progress, and we continue to thank you for your assistance to date, and look forward to working with you in the months to come on this legislation.

Thank you very much.

Senator NICKLES. Ladies and gentlemen, I apologize for a problem that we are having schedule wise, and it is going to be necessary for us to recess this meeting for 10 minutes and I do apologize very, very sincerely. But it is something that is beyond our control.

We will reconvene this meeting at 20 minutes to 11.

[Short recess.]

Senator NICKLES. Our next guests today are Harrison Givens, Jr., vice president, Equitable Life Assurance Society, representing ERISA, and Irvine H. Dearnley, vice president, Citibank, New York, representing the National Association of Manufacturers.

Gentlemen, welcome—and lady.

Mr. Givens, would you care to begin?

STATEMENTS OF HARRISON GIVENS, JR., SENIOR VICE PRESIDENT, EQUITABLE LIFE ASSURANCE SOCIETY, NEW YORK CITY, ACCOMPANIED BY GEORGE PANTOS, COUNSEL, REPRESENTING ERISA INDUSTRY COMMITTEE (ERIC) AND IRVINE H. DEARNLEY, VICE PRESIDENT, CITIBANK, N.A., NEW YORK: ACCOMPANIED BY CLAUDIA VINE, NATIONAL ASSOCIATION OF MANUFACTURERS, REPRESENTING THE NATIONAL ASSOCIATION OF MANUFACTURERS, A PANEL

Mr. GIVENS. Thank you, sir.

My name is Harrison Givens, Jr., senior vice president of the Equitable Life Assurance Society. I am here on behalf of the ERISA Industry Committee (ERIC), and I am accompanied by George Pantos of Vedder, Price, Kaufman, Kammholz & Day, who serve as counsel to ERIC.

ERIC is an association of 115 major corporations concerned with national retirement policy issues. ERIC's members include half of the Nation's 50 largest industrial companies and represent a broad cross section of the Nation's largest retailers, utilities, bankers, and insurers.

My comments here will be confined to certain key issues of the subject of today's hearings, title VI of S. 1541. ERIC will submit a supplemental written statement commenting on title VI in more detail, and on the first five titles of S. 1541 as well.

Title VI of S. 1541 revises substantially the single employer insurance program set up in 1974 under title VI of ERISA. ERIC has an obvious interest in the sound operation of that program, since major plan sponsors such as those represented in ERIC pay 85 percent of its premiums. ERIC's active participation in the analysis of the present program began with the advisory CELI panel of 1977, and ERIC has consulted extensively with Congressional members and staff in the past 2 years, as well as with other business and labor organizations.

The present single employer insurance program requires that a sponsor who terminates his defined benefit plan must thereupon pay in a single sum any unfunded liability for guaranteed benefits, and turn over the plan to the Pension Benefit Guaranty Corporation (PBGC) to administer the plan's assets thereafter. This requirement has three significant problems:

First, the single sum form of payment is too severe in some cases, since the deficiency will not be needed to pay benefits for many years; second, the single sum payment is not enough in some cases, since it is limited to 30 percent of the net worth; third, the PBGC is introduced into every plan termination, even though the plan is already sufficiently funded in 98 percent of the terminations.

Title VI of S. 1541 resolves these problems well by eliminating 30 percent of net worth as a limit on liability; by allowing the sponsor to continue its association with the plan while all vested benefits are fully funded, in no more than 15 years; and by postponing the PBGC's active involvement until the sponsor is in bankruptcy or liquidation. This approach plugs the loophole through which several large employers have escaped within the past year, paying 30 percent of a small net worth and dumping a large remaining unfunded liability onto the insurance system. It provides a reasonable interval over which the continuing employer can complete his funding. And it avoids the unnecessary administrative expenses associated with inserting the PBGC into every plan termination, even though only 2 percent are insufficiently funded, and some of those 2 percent are healthy companies. ERIC therefore heartily endorses this approach.

At the same time, there are several provisions of title VI of S. 1541 that give us grave concern. We believe they would—quite unintentionally—cause major damage to any hopes for expanding or even maintaining defined benefit plans. In the interests of time I will deal with only one here, and leave further comment to my written submission.

The single example is the status of the PBGC's claim in bankruptcy or liquidation.

Under present law, the PBGC's claim has the status of a tax lien, but is limited to 30 percent of net worth. Under present law, therefore, the sponsor's creditors are understandably not greatly concerned with the presence of a defined benefit pension plan. If the sponsor gets into financial trouble, the creditor figures that he will either be repaid in full—in which case the status of the PGBC's claim didn't matter—or he will not be repaid in full, in which case the sponsor's assets are not enough to satisfy all liabilities, so—in normal usage, and surely in the usage intended by the Congress in writing ERISA—there is no net worth, so the PBGC's claim is for zero and again it has not interfered with the creditor's claim.

Whether or not this simple view of net worth is correct under present law, the fact is that present sources of credit—the banks and insurance companies—do not pay much attention to unfunded pension liabilities. Nor, I might add, do institutional purchasers of common stock.

Title VI wisely deletes the 30 percent of net worth limitation. If it then put the PBGC's claim ahead of all equity interests but after all creditors, the effect would be to go from 30 percent of net worth to 100 percent of net worth. The creditor's status hereafter would be essentially the same—the creditor would still either be paid off in full, or, if not, the PBGC would get nothing, so in either case the PBGC's claim would represent no danger to the creditor.

However, title VI puts the PBGC's claim on a par with general creditors. This gives the PBGC access to more than 100 percent of the employer's net worth. This must give the potential creditor considerable concern, since all growth in the plan's unfunded liability dilutes the claims of all general creditors. It is inevitable that this new danger will change the basis for obtaining credit, whether for short-term loans or long-term, whether obtained privately or through publicly-traded securities.

One obvious response by creditors is to require a higher rate on new loans. Companies with large unfunded liabilities and substantial needs for debt financing will therefore be motivated to convert their defined benefit plans to a defined contribution basis and thereby reassure their sources of credit. A more subtle but natural response by creditors is to count increases in unfunded liabilities against present forms of covenant that limit further borrowing, because such covenants are already there to prevent dilution of general creditor claims. This step would for the first time bring the creditor to the bargaining table, restricting the sponsor's ability to increase pensions. It would also militate against continuing the modern form of pension formula, which is based on final average pay, because the liabilities of such plans rise sharply, and automatically, in times of inflation. Ultimately, this must exert considerable additional pressure to switch plans to a defined contribution basis. ERIC is deeply concerned that the general creditor status given by title VI to the PBGC's claim will have the unintended but serious consequence of curtailing not only the growth of defined benefit plans but even their continuance.

If, however, the PBGC's claim is superior to all equity interests but subordinate to creditors' interests, the PBGC has access to 100 percent of the sponsor's net worth, but there is no interference with present terms for access to credit. We believe it is a sufficient discipline that stockholders be required to pay for pension promises in full; requiring creditors to pay for them also will only shift the terms upon which credit is available, and add noticeably to the pressure to abandon defined benefit plans.

We appreciate that a creditor's status for the PBGC's claim makes the insurance program slightly more secure, and we value the program's soundness, since large companies pay 85 percent of the program's premiums. But we value even more a climate that tolerates defined benefit plans, and even encourages their responsible growth, and we gravely fear far-reaching, adverse consequences unless the PBGC's claim is subordinated to creditor's claims.

Thank you, sir.

[The prepared statements of Mr. Givens and ERIC follow:]

Statement Of
The ERISA Industry Committee (ERIC)
to the
SUBCOMMITTEE ON LABOR
# of the
SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES
Regarding
THE RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE SIMPLIFICATION ACT OF 1981
(S.1541)

My name is Harrison Givens, Jr, Senior Vice President of the Equitable Life Assurance Society. I am here on behalf of The ERISA Industry Committee (ERIC), and I am accompanied by George Pantos of Vedder, Price, Kaufman, Kammholz & Day, who serve as counsel to ERIC.

ERIC is an association of 115 major corporations concerned with national retirement policy issues. ERIC's members include half of the nation's fifty largest industrial companies and represent a broad cross-section of the nation's largest retailers, utilities bankers and insurers.

My comments here will be confined to certain key issues of the subject of today's hearings, Title VI of S.1541. ERIC will submit a supplemental written statement commenting on Title VI in more detail, and on the first five titles of S.1541 as well.

Title VI of S.1541 revises substantially the single employer insurance program set up in 1974 under Title IV of ERISA. ERIC has an obvious interest in the sound operation of that program, since major plan sponsors such as those represented in ERIC pay 85% of its premiums. ERIC's active participation in the analysis of the present program began with the advisory CELI Panel of 1977, and ERIC has consulted extensively with congressional members and staff in the past two years, as well as with other business and labor organizations.

The present single employer insurance program requires that a sponsor who terminates his defined-benefit plan must thereupon pay in a single sum any unfunded liability for guaranteed benefits, and turn over the plan to the Pension Benefit Guaranty Corporation (PBGC) to administer the plan's assets thereafter. This requirement has three significant problems:

(1) the single sum payment is not enough in some cases, since it is limited to 30% of the net worth;

(2) the single sum form of payment is too severe in other cases, since the deficiency will not be needed to pay benefits for many years; and

(3) the PBGC is introduced into every plan termination, even though the plan is already sufficiently funded in 98% of the terminations.

Title VI of S.1541 resolves these problems well by eliminating 30% of net worth as a limit on liability; by requiring the sponsor to continue its association with the plan until all vested benefits are fully funded, in no more than 15 years; and by postponing the PBGC's active involvement until the sponsor is in bankruptcy or liquidation. This approach plugs the loophole through which several large employers have escaped within the past year paying 30% of a small net worth and dumping a large remaining unfunded liabil[illegible] the insurance system. It also provides a reasonable interval ov[illegible] which the continuing employer can complete his funding and it avoids the unnecessary administrative expenses associated with inserting the PBGC into every plan termination, even though only 2% are insufficiently funded, and some of those 2% are healthy companies. ERIC therefore heartily endorses this approach.

At the same time, there are several provisions of Title VI of S.1541 that give us grave concern. We believe they would -- quite unintentionally -- cause major damage to any hopes for expanding or even maintaining defined benefit plans. In the interests of time I will deal with only one here, and leave further comment to my written submission.

The single example is the status of the PBGC's claim in bankruptcy or liquidation.

Under present law, the PBGC's claim has the status of a tax lien, but is limited to 30% of net worth. Under present law, therefore, the sponsor's creditors are understandably not greatly concerned with the presence of a defined benefit pension plan. If the sponsor gets into financial trouble, the creditor figures that he will either be repaid in full -- in which case the status of the PBGC's claim didn't matter -- or he will not be repaid in full, in which case the sponsor's assets are not enough to satisfy all liabilities, so -- in normal usage, and surely in the usage intended by the Congress in writing ERISA -- there is no net worth, so the PBGC's claim is for zero and again it has not interfered with the creditor's claim.

Title VI wisely deletes the 30% of net worth limitation. If it then put the PBGC's claim ahead of all equity interests but after all creditors, the creditor's status hereafter would be essentially the same -- the creditor would still either be paid off in full, or, if not, the PBGC would get nothing, so in either case the PBGC's claim would represent no danger to the creditor.

However, Title VI puts the PBGC's claim on a par with general creditors. This must give the potential creditor considerable concern, since all growth in the plan's unfunded liability dilutes the claims of all general creditors. It is inevitable that this new danger will change the basis for obtaining credit, whether for short-term loans or long-term, whether obtained privately or through publicly-traded securities.

One obvious response by creditors is to require a higher rate on new loans, which puts pressure on companies with large unfunded liabilities and substantial needs for debt financing to convert their defined benefit plans to a defined contribution basis and thereby reassure their sources of credit. A more subtle but natural response by creditors is to count increases in unfunded liabilities against present convenants that limit further borrowing, because such covenants are already there to prevent dilution of general creditor claims. This step would for the first time bring the creditor to the bargaining table, restricting the sponsor's ability to increase pensions. It would also militate against continuing the modern form of pension formula, which is based on final average pay, because the liabilities of such plans rise sharply, and uncontrollably, in times of inflation. Ultimately, it must exert considerable additional pressure to switch plans to a defined contribution basis. ERIC is deeply concerned that the general creditor status given by Title VI to the PBGC's claim will have the unintended but serious consequence of curtailing not only the growth of defined benefit palns but even their continuance.

If the PBGC's claim is superior to all equity interests but subordinate to creditors' interests, there is no interference with present terms for access to credit. We believe it is a sufficient discipline that stockholders be required to pay for pension promises in full; requiring creditors to pay for them also will only shift the terms upon which credit is available, and add noticeably to the pressure to abandon defined benefit plans.

We appreciate that a creditor's status for the PBGC's claim makes the insurance program slightly more secure, and we value the program's soundness since large companies pay 85% of the program's premiums. But we value even more a climate that tolerates defined benefit plans, and even encourages their responsible growth, and we gravely fear far-reaching, adverse consequences unless the PBGC's claim is subordinated to creditors' claims.

SUPPLEMENTAL STATEMENT OF
THE ERISA INDUSTRY COMMITTEE (ERIC)
TO THE
SUBCOMMITTEE ON LABOR
OF THE
SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES
REGARDING TITLE VI OF
THE RETIREMENT INCOME INCENTIVES AND
ADMINISTRATIVE SIMPLIFICATION ACT OF 1981
(S.1541)

This statement supplements the ERIC written statement and oral testimony presented on November 12, 1981. For convenience of reference, the points discussed are in the order in which they occur in S.1541, and the page numbers cited are those of that bill.

1. Page 225: No PBGC premiums are required for plans with fewer than 35 participants, a class that comprises perhaps 95% of insured plans. The motivation for this provision is presumably that the present administrative cost of collecting premiums is greater than the amount of premium required for such a case, and that in fact a large number of such plans have not even been identified for collection.

ERIC opposes this provision. The present problems of identifying plans and collecting premiums should be addressed squarely and resolved, rather than preserved by law.

2. Page 226: If PBGC premiums are out of line with coverage limits, the PBGC is to propose raising one or lowering the other.

   ERIC supports this provision. It is consistent with the present provisions applying to multi-employer plans, and is a reasonable way to assure that necessary adjustments will be made in an orderly fashion.

3. Page 232: There is no insurance coverage for an increase in benefits arising from a plan amendment after the onset of bankruptcy, liquidation, etc., if that onset is "part of a process resulting in the occurrence of an insurable event".

   ERIC urges a stronger provision: coverage should not be provided for benefit increases after the onset of bankruptcy, etc., regardless of its cause. To do otherwise is like providing additional medical insurance to someone who has been diagnosed as having a fatal disease.

4. Page 234: Whenever the assets of the terminated plan become sufficient, the plan must buy annuities to pay

all non-forfeitable benefits "or otherwise fully satisfy the obligation to pay all such benefits".

ERIC opposes this provision. An employer who completes the required funding should be permitted to continue the plan as a wasting trust, if the employer wishes to accept the resulting experience gains and losses.

5. Page 235: The PBGC can trigger an insurable event at any time if it determines that a partial liquidation has occurred.

ERIC opposes any right by the PBGC to trigger an insurable event before the onset of bankruptcy, liquidation, etc. After such an onset, however, PBGC should have the right to trigger an insurable event "to protect the interests of the Corporation" whether there is a partial liquidation or not.

6. Page 247: There can be no cash options after bankruptcy, liquidation, etc.

ERIC opposes this provision. Benefit provisions and options previously available to employees should not be taken away from them because of the onset of financial problems for the employer. If the insurance system requires protection against anti-selection by employees peculiar to the condition of the employer's bankruptcy, then limited provisions addressed directly to that problem should be attempted. The present provision appears to be simply a paternalistic effort to keep employees from access to single sum payments lest they waste them.

7. Page 251: If a reportable event is not reported, personal liability is assessed broadly -- to all fiduciaries, to all officers of the control group, etc.

   ERIC opposes this provision. If provisions of the law do not prove adequate in administration, the named fiduciary could be subjected to heavier penalty, but the proposed provision has an excessive reach. (See Attachment A for a more detailed discussion.)

8. Page 254: The period for determining the control group is 15 years if a purpose of a change in membership of the control group is to avoid benefit liability.

   ERIC opposes this provision. Since a change in membership of the control group would always affect the benefit liability of the departing member, it would be almost impossible to establish that such a result was wholly absent from consideration, whatever the principal motivation for change. The effect is to achieve indirectly a uniform 15-year rule. Present law has no "look back" for the control group, and one is needed; but a uniform five-year rule should be quite sufficient.

9. Page 262: The concept of contingent liability on sale of assets is broadened:

    (a) it applies to any change of sponsor; and

    (b) the liability exists up to 15 years after sale (and from five years before sale). The 15 years after sale can be shorter if the PBGC accepts that the unfunded liability would be fully amortizable in a shorter period by half the average net charges to the funding standard account for the three years preceding the sale.

    ERIC opposes this provision, but would support a five-year period of liability after sale.

10. Page 264: This provision would eliminate contingent liability if the new employer is stronger than the old employer; or is strong enough; or in any case if there are fewer than 35 participants, provided that in each case this is demonstrated to the satisfaction of the PBGC.

ERIC opposes requiring that there be a demonstration satisfactory to the PBGC. The liability should be eliminated in the circumstances cited, and if the facts are in dispute they can be adjudicated in the courts.

11. Page 270: When the purpose of a transfer of assets is to evade benefit liability, both the transferee and the transferor are liable.

    ERIC opposes this provision, for much the same reasons as in point 8 above. The addition of five-year periods of protection should be sufficient to control the problem of anti-selection.

12: Page 280. Title VI introduces for single employer plans a concept of "insolvent plans", analogous to a concept now applicable to multi-employer plans: if (page 284) plan assets are less than three times annual benefit payments and the sponsor determines that the plan may not meet the benefit payment requirements of the next three years, then the minimum funding requirements for the year are the benefits of that year.

    ERIC supports this provision.

13. A provision should be added to the bill that endorses the present administrative concept of permitting an employer to "freeze" his plan, avoiding termination but allowing benefit accruals to cease while the vesting clock continues to run.

ATTACHMENT A

REPORTABLE EVENT - PENALTIES

The omnibus bill creates personal legal liabilities on officers, directors, owners, plan fiduciaries, attorneys and plan administrators who fail to meet the notice requirements (reportable event) to the PBGC.

This includes liability:

1) for failing to provide PBGC with timely notice where a contributing sponsor (or any trade or business which is a member of the same control group) restructures a significant amount of debt which results in the reduction of the amount of debt or an extension of the terms of the debt, in circumstances where there exist past due creditors' obligations; or

2) where there is a sale of 10 percent or more of the assets of a contributing sponsor, or any member of the same control group, the proceeds of which are used to satisfy past due creditors' obligations or are distributed to equity interests.

The imposition of personal liability on such persons exceeds current ERISA provisions for failure to meet comparable reporting requirements. While timely notice to the PBGC is appropriate, the imposition of personal liability on corporate directors, officers, etc., for the corporation's failure to provide such notice is unreasonable and unnecessarily punitive. Moreover, it is impractical to expect corporate directors to be aware of actions by affiliated companies such as those events specified above which trigger the filing of a notice to PBGC. To impose personal liability on such persons for failure to report is a form of regulatory overkill. A more reasonable approach would be to impose a specific money amount (such as $100/day) or to limit the liability to the Company's Named Fiduciary (such as the Company or the Plan Administrator).

Senator NICKLES. Thank you, Mr. Givens.

Mr. Dearnley?

Mr. DEARNLEY. Mr. Chairman, my name is Irvine Dearnley, and I am a vice president of Citibank, NA. I have with me today Claudia Vine, of the National Association of Manufacturers, and I am speaking for them in this presentation.

The NAM is an organization of nearly 12,000 members, of every size and industrial classification, located in every State. Our members employ 85 percent of the workers in manufacturing employment, and produce over 80 percent of the Nation's manufactured goods. We would be pleased to work with your Committee in connection with some modifications.

Title VI would make the PBGC a general creditor of the plan sponsor in the event of a pension plan termination with insufficient assets to cover guaranteed benefits under the plan. This provision is proposed, even though the existing limit of 30 percent of the plan's sponsor net worth available to the PBGC in the event of plan termination would be raised to 100 percent of net worth under title VI.

The NAM recommends strongly that this proposed provision be modified to provide the PBGC a position of a subordinate creditor, rather than that of a general creditor. This is a point that Harrison has made so well. If this is not done, the cost of borrowing could be increased substantially, or the availability of any borrowing could be restricted among those companies with a high level of unfunded pension liability to net worth, as these companies may be perceived as less creditworthy by those who would lend them money.

Moreover, such a provision could restrict formation of new defined benefit plans. This could happen because few, if any, small companies would be amenable to impairing their borrowing ability by taking on a past service liability to a new defined benefit pension plan.

Section 6103 of title VI would, as proposed, exempt the sponsor of any single-employer plan with fewer than 35 participants from the payment of currently required annual premiums to the PBGC. Participants in such plans would continue to enjoy benefit guarantees under ERISA but without paying any premiums. This situation was not contemplated under the act, and the NAM suggests that this provision should be removed from the proposed legislation.

The elimination of premiums, even from those plans with under 35 members, would result in the necessity for the PBGC to one, collect added premium income from the remaining plans, or two, reduce its headcount in number sufficiently to offset its reduced income.

Section 6106 would provide that annuity contracts should be purchased for all plan participants whenever plan assets of a terminated plan are sufficient to do so. This provision could deny the plan sponsor a right to continue the ongoing management of a plan that he had fully funded. To the extent that the sponsor would be willing to agree to keep the plan fully funded on an ongoing basis, it would seem that he should be allowed to do so. Moreover, this loss of credit to the plan sponsor among plan participants should not be required. Accordingly, this proposed provision should be modified.

We request that our complete statement be included in the record as we look forward to commenting on the other titles of this bill at a later date.

The NAM appreciates the opportunity to discuss these, as well as other matters involved in the regulation of employee benefits.

I welcome your comments, and will be happy to try to answer any questions you may have.

[The prepared statement of Mr. Dearnley follows:]

STATEMENT OF

IRVINE H. DEARNLEY, VICE PRESIDENT, CITIBANK, N.A.

ON BEHALF OF

THE NATIONAL ASSOCIATION OF MANUFACTURERS

ON S. 1541

THE RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE

SIMPLIFICATION ACT OF 1981

BEFORE THE

SUBCOMMITTEE ON LABOR

COMMITTEE ON LABOR AND HUMAN RESOURCES

UNITED STATES SENATE

November 12, 1981

Mr. Chairman and members of the Subcommittee, my name is Irvine H. Dearnley, and I am a Vice President of Citibank, N.A. I am before you today representing the National Association of Manufacturers. The NAM is an organization of nearly 12,000 members of every size and industrial classification located in every state. Our members employ 85 percent of the workers in manufacturing employment and produce over 80 percent of the Nation's manufactured goods.

As a large number of our members have one or more retirement plan, the NAM is very interested in any congressional proposal which would affect the treatment of these plans under the Employee Retirement Income Security Act (ERISA) and welcomes this opportunity to comment upon Title VI of S. 1541. This proposed legislation would amend substantially Title IV of ERISA, affecting principally the termination provisions related to single employer pension plans.

I will say at the outset that the NAM is supportive of the thrust of Title VI, which is aimed at strengthening the assurance of the payment of benefits to participants in terminating pension plans. Certain concepts of Title VI, however, would appear to need refinement and further consideration, while others may need to be considered for deletion. We would be pleased to work out modifications with you. I will discuss certain of these nearer the end of my prepared remarks.

To be able to comment understandably upon Title VI of the proposed legislation, it is necessary to put into context the provisions of Title IV of ERISA that are proposed to be modified.

Existing Legislation

As enacted, ERISA provides certain benefit guarantees to vested participants in terminating pension plans. The first level of assurance for these guarantees to participants, after pension trust funds, is a portion of the net worth of the sponsoring employer. The next level of assurance is the Pension Benefit Guaranty Corporation (PBGC) funded by annual contributions paid by plan sponsors on behalf of each plan participant (now $2.60).

Originally, the Act provided for the concept of contingent employer liability insurance. Under "CELI," plan sponsors would have been able to insure against the possible loss of net worth due to plan terminations with insufficient assets to cover plan liabilities. The "CELI" concept proved to be unworkable and was repealed in 1980 under provisions of H.R. 3904 and S. 1076.

Under existing law, the sponsor of a pension plan terminating with insufficient assets to meet the plan benefits guaranteed by the Act is liable to the PBGC. The PBGC effectively has a tax lien to help assure an up-front, single sum payment to it by the plan sponsor, up to 30% of the sponsoring employer's net worth.

Upon plan termination, participants now must look solely to the PBGC for payment of their promised benefits. The plan sponsor ceases to have any responsibility related thereto, even though he may continue in business, and may even commence a new pension plan immediately for the very same employees. The loser in each such situation is the remainder of the private pension community, whose annual premium payment to the PBGC must be increased sufficiently to cover unfunded liability of all of these terminated insufficient plans.

Therefore, legislation that would make more difficult this transfer of unfunded pension liability to the Pension Benefit Guaranty Corporation from terminating private pension plans is welcome.

Proposed Modifications under Title VI

Title VI proposes principally to (a) eliminate the 30% cap on plan sponsor liability to the PBGC, with resultant exposure of

100% of net worth to satisfy unfunded pension plan liability, (b) eliminate a lump sum payment to the PBGC and require instead continued funding of liability over 15 years, while the plan sponsor remains in business, (c) cause the PBGC to assume the position of a general creditor, rather than possess a preferential tax lien, in case of plan termination, (d) require the PBGC to assume plan responsibility only in the event of plan termination or bankruptcy of the plan sponsor, (e) permit the sale and purchase of solvent companies without undue involvement of the PBGC, and (f) generally raise the level of benefits that would be guaranteed.

These proposed modifications to Title IV of ERISA should, as a package, reduce substantially the ability of plan sponsors to shift unfunded pension liability to the PBGC and to the general pension community and should concurrently strengthen the funding of existing PBGC liability, by reducing PBGC administration costs and limiting future liability.

Proposed Legislation is Timely

The timeliness of the proposed legislation is reflected in the Financial Highlights of the PBGC's Annual Report to the Congress for fiscal year 1979, which shows a deficiency in assets of more than $146 million. This is a substantial increase over the 1978 deficiency, and represents a PBGC liability that must be made up among viable plans. Most pension plan sponsors are not responsible for this increased liability, but their overall pension costs must increase, to provide PBGC the necessary funding for these less well managed plans.

It can be anticipated that passage of the proposed legislation, as contained in Title VI, with its more stringent rules for plan termination, as well as establishing liability for continued funding of plans by sponsors who remain in business, would result in a substantial slowing of liability transfer to the PBGC. This, in turn, would lessen demands on the PBGC's annual premium income. For these reasons, the National Association of Manufacturers generally would support the thrust of Title VI of S. 1541.

PBGC would be General Creditor

As written, Title VI would make the PBGC a general creditor of the plan sponsor in the event of a pension plan termination with insufficient assets to cover guaranteed benefits under the plan. This provision is proposed, even though the existing limit of 30% of the plan's sponsor net worth available to the PBGC in the event of plan termination would be raised to 100% of net worth under Title VI.

The NAM recommends strongly that this proposed provision be modified to provide the PBGC a position of a subordinate creditor, rather than that of a general creditor. If this is not done, the cost of borrowing could be increased substantially, or the availability of any borrowing could be restricted among those companies with a high level of unfunded pension liability to net worth, as these companies may be perceived as less credit-worthy by those who would lend them money.

Moreover, such a provision could restrict formation of new defined benefit plans. This could happen because few, if any, small companies would be amenable to impairing their borrowing ability by taking on a past service liability to a new defined benefit pension plan.

Eliminate PBGC Premium for Plans With Under 35 Participants

Section 6103 of Title VI would, as proposed, exempt the sponsor of any single employer plan with fewer than 35 participants from the payment of currently required annual premiums to the PBGC. Participants in such plans would continue to enjoy benefit guarantees under ERISA but without paying any premiums. This situation was not contemplated under the Act, and the NAM suggests that this provision should be removed from the proposed legislation.

The elimination of premiums, even from those plans with under 35 members, would result in the necessity for the PBGC to (1) collect added premium income from the remaining plans, or (2) reduce its headcount in number sufficiently to offset its reduced income.

Purchase Annuity Contracts If Plan Terminates

Section 6106 would provide that annuity contracts should be purchased for all plan participants whenever plan assets of a terminated plan are sufficient to do so. This provision could deny the plan sponsor a right to continue the ongoing management of a plan that he had fully funded. To the extent that the sponsor would be willing to agree to keep the plan fully funded on an ongoing basis, it would seem that he should be allowed to do so. Moreover, this loss of credit to the plan sponsor among plan participants should not be required. Accordingly, this proposed provision should be modified.

Continuing Liability

Section 6119, which deals with liability following the change of contributing sponsors, could continue such liability for up to 15 years if the acquiring plan sponsor cannot demonstrate to the PBGC that it has greater net tangible assets than certain prior sponsors have had over the past 5 years. Strict enforcement of any such provisions could seriously limit the number of companies that might be willing to acquire another company, even though it would be to the financial advantage of every concerned.

Title I of S. 1541

Title I of S. 1541, the Employee Benefit Administration, would consolidate the administration of ERISA, which now involves the Departments of Labor and Treasury, as well as the Pension Benefit Guaranty Corporation, into a single new agency. The NAM has expressed opposition to the single agency concept previously, in regard to S. 209, the "ERISA Improvements Act," and in regard to H.R. 6053, the "Retirement Income Incentives and Administrative Simplification Act of 1979."

The existing shared jurisdiction between Labor and Treasury has been responsible in the past for certain duplication of effort as well as delays in promulgating certain ERISA regulations. However, such shared jurisdiction has been responsbile for a more balanced administration. There has been, and should continue to be, improvement in administration due to the concerted efforts of the respective departments to reduce duplication, coordinate plan filing requirements and generally cut down on required paperwork.

One of the reasons for not creating a single agency is the problem of coordinating compliance. An employee benefits agency would continue to fall far short of solving the multiple jurisdictional problems. The Department of Treasury (Internal Revenue Service) would continue to maintain responsibility for the assessment and collection of taxes. Further, the Department of Labor would continue to maintain responsibility over matters concerning labor unions and multiemployer plan interests. These continuing responsibilities would make the establishment of a single agency to administer ERISA a difficult goal, at best.

As stated earlier, there have been managerial improvements in the existing shared administrative structure in reducing the amount of paperwork required of pension plans. For example, there were significant reductions in 1979 and there is ample evidence that these efforts are continuing. Further, the NAM believes that the creation of a new single agency might increase, rather than decrease, the amount of paperwork required of regulated plans. This could come about, for example, if the proposed new agency were to establish its ERISA reporting requirements separately from the needs of the Internal Revenue Service in regard to tax information.

Another concern held by the NAM is the disruptive effect that consolidation of administration into a single new agency could have on current operations. For example, any new agency would need adequate time to obtain new quarters, establish a field system, secure and train staff, etc. Any such reorganization could take years. Moreover, any loss of IRS logistics support could prove particularly disruptive to administration.

These are among the reasons why the NAM continues to oppose authorizing a separate agency to administer ERISA. The existing shared administrative structure delegates the responsibility of administering the various aspects of ERISA to the agencies with the appropriate expertise and interest. Many problems associated with administering this admittedly complex law have been successfully addressed, and do not require changes.

Conclusion

We look forward to commenting on the other titles of this bill at a later date. The NAM appreciates the opportunity to discuss these, as well as, other matters involving the regulation of employee benefits. I welcome your comments and will be happy to try to answer any questions you may have.

Senator NICKLES. Thank you, Mr. Dearnley.

I will make this comment for all of our guests today, even though the hearings today are particularly on title VI, you can submit your written comments on the balance of the titles.

Mr. Dearnley, is the ERIC group supportive of the overall concept of what we are trying to do in S. 1541, on noting the exemptions that you are talking about?

Mr. GIVENS. You are asking about ERIC's position?

Senator NICKLES. Yes.

Mr. GIVENS. I think we have, in general, a very good feeling about S. 1541. There are provisions in title VI that give us concern. There are provisions elsewhere that we need to communicate our feelings on, but certainly we support the idea of the very important relief offered in S. 1541 for prohibitive transactions, reduction of paperwork, a number of these things are right on.

Senator NICKLES. There are several things that are done in title VI, and I am assuming, or thinking of your testimony, that you like the idea of changing the insurable event. You like the idea of changing the percentage of net worth from 30 percent to 100 percent.

Mr. GIVENS. Right.

Senator NICKLES. You have some reservations or objections to the general creditor status?

Mr. GIVENS. Because the effect of making the PBGC's claim on a par with creditors is to go beyond 100 percent of net worth. Even if there is not any net worth, the PBGC has the same claim.

Senator NICKLES. If there is no net worth, you are not going to have anything, PBGC will not receive it in writing.

Mr. GIVENS. It will receive the 40 cents on the dollar, say, as any other creditor. There is the problem: If you want to keep the claim to 100 percent of net worth, then you have to make it subordinate to general creditors.

Senator NICKLES. To go a little bit further on that, you mentioned the fact that it needed to be subordinate. That is under tax liens, and would be under general creditors.

Mr. GIVENS. You would wipe out the stockholders completely, if necessary.

The employer will pay—that means all equity interests will pay for the benefits that have been promised, fully as far as they have funds, but you will not go and ask the creditors to pay also, because if you do, the creditors will protect themselves, and you are hurting the employer, you are hurting the business, you are hurting the employee.

Senator NICKLES. The creditors would protect themselves; do you mean they would look closer before they would make a loan?

Mr. GIVENS. I suggested two responses. One is to charge a higher rate, and you can say that is sad, but tolerable, because the interest rate is deductible anyway.

A more important reaction, and a natural one, is to use here the same general approach that is already in use, whereby a lender protects himself against further borrowings by the same employer. You cannot go around from one bank or insurance company to the next and borrow independently. Once you borrow, you restrict yourself from borrowing further, because the banker or the insurance company or whatever the source of credit, such as the public markets, to be diluted by further claims. This PBGC claim is a further claim.

The natural extension to protecting the creditor from dilution of his claim is to count any increase in unfunded pension liability against those limits. That means that the employer, now, in order to protect the sources of credit, cannot afford to let his pension liability increase.

At best, that is a difficult discipline. The easy answer to that is, let us not have a benefit plan.

Senator NICKLES. I think a lot of employers have made that decision.

We looked in our earlier hearings at the number of defined benefit new plans, and they have dropped off considerably since enactment of ERISA, and the very large population of new plans have been going in under the defined benefit or defined contribution.

Mr. GIVENS. That is true, and I think it is a very regrettable consequence. The defined contribution basis is fine, but the defined benefit approach is the only one that will deliver sensible benefits for everyone, and it is a shame that the present law stacks the deck so much against defined benefit plans. I think this could be the final straw.

Senator NICKLES. I would still like for you to clarify, why you think PBGC should be in a status less than general creditors? Granted if you have an insolvency or liquidation, it may dilute the other creditors, and I can see if you are representing those other creditors, you can say I do not want PBGC coming in and getting their share of the pie. But when you have a firm's liabilities, whether it be pension liabilities or a liability to the bank, why should a pension liability be subordinate to other liabilities that a firm has incurred?

Mr. GIVENS. All right. Sometimes this particular proposal of title VI is referred to as saying we will go from 30 percent of net worth to 100 percent of net worth. Now, that is what I would like to see you do. I would like to see you go from 30 percent of net worth to 100 percent, but not to unlimited, and that is what you have done.

By failing to have the PBGC subordinate to general creditors, you have allowed the PBGC to reach in and get money, even when there is no net worth.

Senator NICKLES. On an equal basis with other creditors.

Mr. **Givens**. Yes, but it means that the general creditors, instead of settling for 70 cents, say will settle for 40 cents. There is no net worth, but the PBGC will get the same standing.

What you have done is make the stockholders pay for the benefits, yes, but also the creditors, and my point is that that is not what is going to happen. The creditors will react by saying we do not want that risk, thank you. You must borrow on a basis that does not expose us.

Senator **Nickles**. Let me ask Mr. Dearnley a question, and this may not be in connection with your NAM testimony.

Does not Citibank and most of the major banks, when they are looking at loans for corporations, are not sophisticated enough to look at the pension liabilities of certain firms and see if this increases the probability of that firm possibly going bankrupt, and not being able to make loan payments?

Mr. **Dearnley**. I should hasten to point out that while I work for a bank, I am not a banker. I would assume that there are some sophisticated bankers who look at such things, and there are many others who do not.

Mr. **Givens**. Sir, I could answer that, and I think I referred to it in my testimony. It depends upon the person you ask. If you ask the head of the company, he says I am sure those fellows looked into that very appropriately; if you ask the people who lend the money, they do not.

That is a fact of life, and as I have tried to indicate, it is a perfectly reasonable fact. Because what you and I think of as net worth, means the excess of your assets over your liabilities. If you cannot pay your liabilities, you do not have net worth. That may or may not be what the statute says, but it certainly is what Congress intended, and it is the way the world is interpreting it today.

Therefore, a lender says the presence of a pension plan does not really bother me. If the borrower does not get into trouble, I have no problems. If he does get into trouble, one of two things: (a) I will get paid off in full, or (b) I will not get paid off in full, in which case the assets do not exceed liabilities, there is no net worth, and the PBGC can have any status it wants for 30 percent of zero. It does not matter. So the lenders very reasonably today assume that net worth means what it means in normal conversation, and that 30 percent will not impair a creditor.

The same thing is true for people who appraise stocks for purchase. They look at credit and debt, the equity-to-debt ratio. There was a book that came out in 1976, by three very sophisticated people in the financial community, which told investors to be very careful to include the unfunded pension liability in your ratio calculations, the ratio of equity to debt. But nobody is doing it.

Senator **Nickles**. Well, I can see they are not doing it. I think a prudent lender should be taking into account the fact that to ignore pensions because they are not up front on a balance sheet is not, to me, not using the best——

Mr. **Givens**. It is not a matter of the balance sheet. The numbers are footnoted there, and the lender can find it very easily.

My point is that the lender, I think correctly, using the natural interpretation of net worth, realizes he is not interfered with.

Now, the stockholder is. The stockholder, the one who purchases common stock, ought to pay attention to it. I am saying that though he should, he does not. The lender today, I think, has a very reasonable case for not paying attention to it, because he takes a reasonable definition of net worth.

Senator **Nickles**. I do not doubt in many cases that the lender and the stockholder do not pay attention to the vested liabilities. However, I do not give that credence for saying that PBGC should be subordinated to the other creditors.

I am looking at the claims. I am willing to discuss it, and maybe increase our knowledge in this area, because I realize there is some considerable contention over it.

I appreciate the administration's comments on it, and I also appreciate your comments.

Let me ask you one additional question. Under the multiemployer amendments, and I am no defender of the amendments that were passed in 1980, but of those, it places the general creditor status, and if we went to subordinate, you would have PBGC and general status under general employer.

Mr. **Givens**. The status of the PBGC's claim for multiemployer plans is subtle. The multiemployer bill deleted the tax lien status with respect to multiemployer plans, and it deleted the 30 percent of net worth, limitation, but it was silent about what was to replace it.

The only way you can read the law is to say that PBGC must stand in the same position as the plan. The plan has a claim—you owe me so many dollars—it therefore must be an unsecured creditor. I think that is where you come out.

Now, Emerson said, "a foolish consistency is the hobgoblin of little minds." There are so many inconsistencies between the two programs that there is no reason to pick on one area where they must be consistent. They are fundamentally different conceptually, because, with a single-employer plan, the employer voluntarily initiated the plan, designs the benefits himself, and accrues liability with respect to his own employees. The financial success of that plan depends upon the employer's financial health alone, and the liabilities of it are his own, no one else's.

Whereas in the multiemployer program, employers bargain about the input, and some other people go off and decide what that input will support. The health of that program is not determined by the individual employer, but by the health of the industry. The liabilities are for other employees than his own.

These two situations are very different conceptually, and Congress has distinguished them right along. The programs started with two different funds—one for the multiemployer program, and a separate fund for the single employer program.

The coverage dates were different: automatic coverage for single-employer plans from 1974, whereas coverage for the multiplans did not become effective until 1980.

Different premiums—single employer plans have paid $2.60 per employee since 1977, but the multiplan is now paying $1.40, and will not pay $2.60 for another 8 years.

There are different phaseins of coverage. The single plan phases in at 20 percent a year. The multiemployer plan has a 5-year cliff—no phasein for 5 years.

There are different guarantees. We guarantee under the single employer program benefits of over $1,000 a month, even if accrued in only 10 years. The multiemployer program guarantees so much per year of coverage—$5 in full, and then 75 percent of the rest—different coverage altogether.

There is different liability on the sale of assets. Under the present law, or under title VI as you propose, the treatment for single plans upon a sale of assets is different from that under the multiemployer program, which limits the employer's liability on the sale of assets to a fraction of net proceeds which runs from 30 percent of the first $2 million up to 80 percent above $10 million of sale value.

There are different cutback provisions. A multiemployer plan can cut back any benefits that have not been in force for 5 years.

There is clearly an almost endless list of differences between the two insurance programs, so why pick on the status of the PBGC's claim to be consistent?

Senator NICKLES. I knew when I asked you that question I had some reservations about it. [Laughter.]

I have just a general question. One for National Association of Manufacturers. You represent what, a lot of large manufacturers, small manufacturers, a variety?

Ms. VINE. Eighty percent of our members are small members in that they have 500 or fewer employees.

Senator NICKLES. I notice your comments on opposing the exemption for the premium payments for firms or plans with 35 or smaller, and I had some thoughts on that, too. The primary thought or conception there being that they are covered, they are receiving "some insurance" or some coverage, therefore they should contribute to the cost as the rest; is that right?

Mr. GIVENS. I would like to comment on that.

The General Accounting study said that—stated as much as—this is in the Wall Street Journal on Tuesday, as much as 3.7 million may not have been paid in 1977. So what this provision does is ratifies the existing inadequate legislation.

I think conceptually it is unfair for employees to get the coverage and not pay for it.

Senator NICKLES. So ERIC is also in favor of eliminating that for that portion of it?

Mr. GIVENS. That is right, we would not want to see the small employer excused on the grounds of equity.

Senator NICKLES. Overall, too, with NAM and ERIC, do you feel like this legislation and the concept of where we are moving, not necessarily each, we spent all morning on the creditor status, but that is a very, very—overall we are talking about some changes in title VI and other changes to fiduciary responsibility, do you feel like it is important for Congress to move at this time?

Mr. GIVENS. Oh, yes, as far as title VI is concerned, the PBGC program and ultimately the large premium payers, who pay 80 percent of that cost, are exposed to a serious and unconscionable potential for abuse. It ought to be fixed now.

It is also important, as Mr. Niskanen said, not to introduce the PBGC into all terminated plans, 98 percent of which are sufficiently funded.

There are many other desirable provisions in your bill—the prohibited transactions relief which, as we have seen after seven years, requires legislative change to amplify the trivial administrative relief that has been accomplished.

The extreme burden of paperwork, where so much money is being spent producing pieces of paper that the Government cannot find—there is no excuse for that.

Senator NICKLES. Gentlemen, we appreciate your comments and we would also like to advise you that I would anticipate we will have additional questions to you, especially if you are not scheduled to testify on the remainder of the bill, we would actually solicit your comments on the other sections of the bill.

Thank you very much.

Our next witnesses, we have the United Steelworkers of America, Thomas Duzak, pension department, accompanied by John Sheehan, legislative director, and S. Howard Kline, counsel for employment benefits.

I might mention, too, everybody's comments will be entered into the record in full and so we would appreciate if you would somewhat capsulize your comments so we can move into some questions.

STATEMENTS OF THOMAS DUZAK, PENSION DEPARTMENT, WASHINGTON, D.C., ACCOMPANIED BY JOHN J. SHEEHAN, LEGISLATIVE DIRECTOR AND S. HOWARD KLINE, COUNSEL FOR EMPLOYMENT BENEFITS, PITTSBURGH, PA.

Mr. DUZAK. Yes; I will do that.

As a matter of fact, recognizing that the statement will be entered into the record, I will summarize the statement by referring to the more salient and key excerpts that are written here.

First of all, we would like to thank you for the opportunity to present the statement on behalf of Lloyd McBride, president of the United Steelworkers of America, regarding S. 1541. We oppose the enactment of S 1541. We do it for three reasons: First of all, we share the view of others who have already testified before the subcommittee that amendments to ERISA, including S. 1541, should not be considered at this time because of the nature of the legislative process as it relates to employee benefit plan matters.

As we have seen recently in the case of the Multiemployer Pension Plan Amendments Act of 1980, any attempt to amend ERISA, particularly in the form of an omnibus bill such as S. 1541, involves a process which is highly unpredictable.

Moreover, we believe that plan sponsors are able to comply with ERISA in a workmanlike manner. Congressional attempts at this time to enact wholesale amendments to ERISA can only upset the understanding and acceptance which is the result of 7 long years of work by all parties concerned with employee benefit plans.

Second, we do not believe that amendments to ERISA are necessary at this time. Given the complexity of ERISA, the shortage of personnel and related startup difficulties which confronted the agencies in 1974, it was inevitable that administrative and compliance problems would arise shortly after its enactment. It is clear, however, that these problems have now been largely solved and we are hopeful that progress will continue to be made.

To use some examples regarding prohibited transactions, we believe that the plan sponsors have, for the most part, been eliminated. To fundamentally weaken the fiduciary responsibility provisions of ERISA to solve a problem which has largely been solved administratively is unwarranted.

Similarly, early problems with the agency's administration of some of the reporting and disclosure provisions of ERISA have been cured, and particular attention has been paid to the problems of small employers. Less information is now required and must be submitted less frequently.

Finally, we oppose S. 1541 because many of its provisions would significantly reduce worker protections under ERISA in three key areas.

With respect to fiduciary responsibility, we believe enactment of S. 1541 would make it far more difficult for plan participants and the Department of Labor to be sure that plans are complying with the remaining fiduciary standards in the law, particularly in light of the sharp cutbacks in budget and staff at the Department of Labor.

Enactment of section 3505 would frustrate the ability of the Federal Government to assure integrity in the administration of plans and the investment of assets.

Regarding the proposed changes in disclosure requirements, we believe that, taken together, they would seriously undermine the ability of workers to protect their interests and make it extremely difficult for participants and beneficiaries to review the operation of their plans.

Regarding the changes proposed in title IV, we believe S. 1541 would threaten worker protection by increasing the likelihood that guaranteed benefit levels under title IV would be reduced. In contrast, section 6104 would provide for an automatic downward adjustment of the level of termination insurance guarantees under certain conditions. This change is extremely harmful to workers. The establishment of meaningful basic-benefit guarantee levels in the termination insurance program represents one of the cornerstones of ERISA.

S. 1541 is a drastic and unconscionable violation of that contract with workers.

Finally, I wish to comment on the need to maintain the solvency of the insurance program under title IV. The United Steelworkers and many other unions and employers have become increasingly concerned that ERISA may permit a company in certain instances to dump pension plan liabilities onto the insurance system. We are hopeful that this apparent loophole in title IV can be closed administratively. If the problem cannot be solved by the PBGC without legislation, the union would be willing to work with other interested parties in the development of remedial legislation limited to the single employer termination insurance program. Our objective would be to preserve the existing formula for determining maximum guarantee levels as well as to assure the long-term fiscal integrity of the program. We believe that a premium increase of appropriate size is a necessary component of any future legislation in order to restore the balance between premiums and the basic-benefit guarantee levels.

Also any such legislation must provide for the protection of pension benefits related to plant shutdowns after the liquidation of the plan sponsor has commenced.

In conclusion, 7 years after its enactment, ERISA is working well, in our opinion. The addition of unnecessary amendments to ERISA, such as those contained in S. 1541, would inevitably bring back much of the confusion and frustration which characterized the period immediately following ERISA's passage. It would also destroy much of the progress already achieved through administrative decisions and set in motion new problems as additional interpretations of a new law would be sought. The legislative process is difficult and unpredictable. The alleged problems which S. 1541 purports to remedy have been dealt with administratively. In other cases, such as "pension dumping," the need for legislation has not been fully established.

Furthermore, many of the provisions of S. 1541 would, in fact, reduce worker protections. For all these reasons, the United Steelworkers of America opposes the enactment of S. 1541.

[The following statement was received for the record:]

Testimony of
Lloyd McBride, President
United Steelworkers of America

S.1541

The Retirement Income Incentives and
Administrative Simplification Act of 1981

United States Senate
Committee on Labor and Human Resources
Subcommittee on Labor and Human Resources

November 12, 1981

On behalf of the United Steelworkers of America, I would like to thank you for the opportunity to testify before the Sub-committee on Labor and Human Resources as it considers S. 1541. The future of employee welfare and pension benefit plans and the nature of the federal government's regulation of those plans are issues of key importance to the working people of our nation. We hope that the result of the Sub-committee's current activities will be to enhance the well-being and security provided to employees by their pension and welfare benefit plans.

Background

The United Steelworkers of America has long been directly involved with the development and growth of employee benefit plans. Virtually all of our nearly 1.3 million members are covered by collectively bargained plans of one form or another. Our comments today reflect many years of first-hand experience with the development of employee benefit plans and the federal government's role in regulating these plans.

We have always been particularly supportive of the termination insurance program set forth in Title IV of ERISA. Because of this termination insurance, workers are likely to receive retirement benefits even if their pension plan terminates and plan assets are insufficient to provide the benefits which have been promised. But for the presence of the termination insurance program, the heartbreak and tragedy typified by the termination of the Studebaker pension plan would frequently have been repeated to the detriment of not only the affected employees but of American society as well. Although the termination insurance program enacted by Congress as part of ERISA in 1974 did not completely solve the problem of broken pension promises, the insurance program that was put into place represented a tremendous advance in employee retirement income security. It is against this background that I turn to S. 1541.

The United Steelworkers of America opposes the enactment of S. 1541. We do so for three basic reasons.

I. LEGISLATION IS UNPREDICTABLE

First of all, we share the view of others who have already testified before the Sub-committee that amendments to ERISA, including S. 1541, should not be considered at this time because of the nature of the legislative process as it relates to employee benefit plan matters. As we have seen recently in the case of the Multiemployer Pension Plan Amendments Act of 1980 (which addressed a specific problem involving only one kind of pension plan), any attempt to amend ERISA, particularly in the form of an omnibus bill such as S. 1541, involves a process which is highly unpredictable.

The result may well be serious cutbacks in the protections now afforded plan participants and beneficiaries.

Moreover, we believe that plan sponsors are able to comply with ERISA in a workmanlike manner. Congressional attempts at this time to enact wholesale amendments to ERISA can only upset the understanding and acceptance which is the result of seven long years of work by all parties concerned with employee benefit plans. ERISA is an exceedingly complex law and the regulations which are its progeny are equally, if not more, complex. It took Congress several years to enact ERISA, due in large part to the difficulties of the issues and the dangers inherent in proceeding too quickly. We believe these same risks would be equally present in any attempt to amend ERISA in so broad a fashion and so short a period as is contemplated by S. 1541. For these reasons and because there is no consensus or demonstration of need, we oppose the enactment of S. 1541.

II. AMENDMENTS ARE NOT NECESSARY

Secondly, we do not believe that amendments to ERISA are necessary at this time. Given the complexity of ERISA, the shortage of personnel and related "startup" difficulties which confronted the agencies in 1974, it was inevitable that administrative and compliance problems would arise shortly after its enactment. It is clear, however, that these problems have now been largely solved and we are hopeful that progress will continue to be made. Indeed, this progress is reflected in those numerous provisions of S. 1541 which would amend ERISA merely to confirm administrative agency actions already put into place by the Department of Labor, Internal Revenue Service and the Pension Benefit Guaranty Corporation. To engraft a 285 page bill onto one of the most complex laws ever passed can only jeopardize the progress achieved by administrative action. It would also make further progress more difficult.

Some important examples should be noted in this regard.

Prohibited Transactions

At present, transactions between plans and parties-in-interest are generally prohibited. Many plan sponsors have argued that it is difficult to assure compliance with these provisions. But in recent years the administrative process has improved considerably and has virtually eliminated this uncertainty as to the status of normal transactions under the law. Adequate guidance as to the meaning of the statutory class exemptions has been provided. Individual requests for variances are now generally acted upon within three months following the date of receipt by the Department of Labor. The so-called compliance problem has for the most part been eliminated. To fundamentally weaken the fiduciary responsibility provisions of ERISA to solve a problem which has largely been solved administratively is unwarranted.

Reporting and Disclosure

Similarly, early problems with the agencies' administration of some of the reporting and disclosure provisions of ERISA have been cured. Particular attention has been paid to the problems of small employers. Less information is now required and must be submitted less frequently. Annual reports are now sent only to the Internal Revenue Service and the EBS-1 plan description form has been eliminated. We also understand that the Labor Department is now considering a recommendation by its Advisory Council to consolidate the individual benefit statement and the summary annual report into a single form. The agencies have addressed reporting and disclosure problems under ERISA as they have arisen and amendments to ERISA which "solve" such problems are unnecessary.

III. WORKER PROTECTIONS ARE REDUCED

We also oppose S. 1541 because many of its provisions would significantly reduce worker protections under ERISA in three key areas.

Fiduciary Responsibility

ERISA now generally prohibits transactions between plans and parties-in-interest in order to avoid conflicts of interest and self-dealing. Without the prohibitions contained in Section 406(a) of ERISA and Section 4975(c) of the Internal Revenue Code, it would be far more difficult for plan participants and the Department of Labor to be sure that plans are complying with the remaining fiduciary standards in the law, particularly in light of the sharp cutbacks in budget and staff at the Department of Labor. These prohibitions also demand the awareness by fiduciaries of their responsibilities under ERISA. Enactment of Section 3505 would frustrate the ability of the federal government to assure integrity in the administration of plans and the investment of assets.

Disclosure Requirements

Another example of how the bill would reduce worker protection is found in the provisions which curtail the disclosure requirements of ERISA. Section 3206 permits updated summary annual reports to be distributed once every ten years rather than every five years. Section 3207 allows summary annual reports to be posted at a worksite rather than be actually distributed to participants. Other provisions of S. 1541 would eliminate both the notice to a former employee that he or she is not vested and the automatic distribution of summary annual reports to retirees. These amendments, taken together, seriously undermine the ability of workers to protect their interests and make it extremely difficult for participants and beneficiaries to review the operation of their plans.

Guarantees Lowered

We also oppose the enactment of S. 1541 because it would threaten worker protection by increasing the likelihood that guaranteed benefit levels under Title IV would be reduced.

At present, the level of termination insurance guarantees is established by law and is adjusted upwards automatically in response to increases in the cost of living. In contrast, Section 6104 would provide for an automatic downward adjustment of the level of termination insurance guarantees if Congress failed to reject a report by the PBGC stating that the existing premium rates could not support the existing basic-benefit guarantees.

This change is extremely harmful to workers. The establishment of meaningful basic-benefit guarantee levels in the termination insurance program represents one of the cornerstones of ERISA. We note that under present law not all pension benefits are insured in the event of plan termination. ERISA insures only certain "basic" benefits, despite the efforts of unions to achieve broader coverage.

S. 1541 would threaten those guarantees by allowing a downward adjustment of benefit protection instead of increasing premiums to meet the actual termination experience. ERISA was enacted in 1974 to safeguard promised pension benefits. If indeed plans do terminate, it would be ironic if Congress would allow the withdrawal of the protection which workers felt they obtained and the government provided in 1974. S. 1541 is a drastic and unconscionable violation of that contract with workers.

Maintaining Solvency Of The Insurance Program

The Steelworkers and many other unions and employers have become increasingly concerned that ERISA may permit a company in certain instances to "dump" pension plan liabilities onto the insurance system. In those instances in which the guaranteed unfunded vested liabilities of a company's pension plan exceed 30% of the company's net worth, a company could benefit significantly by terminating the plan and "trading" 30% of its net worth for a greater amount of PBGC insurance benefits. We are hopeful that this apparent loophole in Title IV can be closed administratively. If the problem cannot be solved by the PBGC without legislation, the Union would be willing to work with other interested parties in the development of remedial legislation limited to the single employer termination insurance program. Our objective would be to preserve the existing formula for determining maximum guarantee levels as well as to assure the long-term fiscal integrity of the program. We believe that a premium increase of appropriate size is a necessary component of any future legislation in order to restore the balance between premiums and the basic-benefit guarantee levels. Also, any such legislation must provide for the protection of pension benefits related to plant shutdowns after the liquidation of the plan sponsor has commenced.

Conclusion

Seven years after its enactment, ERISA is working well. The addition of unnecessary amendments to ERISA, such as those contained in S. 1541, would inevitably bring back much of the confusion and frustration which characterized the period immediately following ERISA's passage. It would also destroy much of the progress already achieved through administrative decisions and set in motion new problems as additional interpretations of a new law would be sought. The legislative process is difficult and unpredictable. The alleged problems which S. 1541 purports to remedy have been dealt with administratively. In other cases, such as "pension dumping," the need for legislation has not been fully established. Furthermore, many of the provisions of S. 1541 would, in fact, reduce worker protections. For all these reasons, the United Steelworkers of America opposes the enactment of S. 1541.

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Senator NICKLES. A couple of comments or questions, Mr. Duzak. I guess I will try to center most of them on the title VI of the bill.

Do you agree with us that it is necessary to legislatively close the possibility that exists or does exist and is now happening under current law to eliminate the dumping of employees taking advantage of the law because they have low net worth and have been able to throw their liabilities on the employers in the country?

Mr. DUZAK. I think the key word is "possibility". There is litigation pending involving the PBGC and Facet Enterprises which has been cited by many as the classic example of pension dumping. And at this point in time, that litigation has not been concluded. There is a provision in title IV currently which provides for the restoration of plans in certain instances and that provision of the current law is being tested.

So, at this point in time, we would agree that if the administrative problem cannot be solved administratively, then one would have to consider the possible need for legislation but, at this time, we think that it is too early. And also we would feel that if the need for legislation does arise or becomes more clear, then one must look at—one must focus on title IV and consider such factors as the need for an appropriate premium increase so that we do not have to come back and seek one at a later date or otherwise risk the loss of needed benefit protection that currently exists.

Senator NICKLES. Here again on title IV, or title VI of our bill, we had, the administration testify; we had other experts, almost everyone has agreed today that, yes, there is a need to make some changes. The law, as it is, is open for abuse, and I think it is in the best interest of working Americans whom you represent and who I am trying to assist in this legislation to stop abuse of the system that might tear down the entire insurance program that was designed for those very workers.

What would happen if we have a major employer—and you mentioned the Facet case of the dollars not so enormous—but what would happen under an existing system? We have liabilities, as mentioned, of $100 million, but it could be $200 million if I understood Mr. Nagle's comments, and could grow substantially. What happens if we have a major company with major unfunded vested liabilities that premiums would have to increase, we are talking about $2 or $5 now in a dramatic—dramatic portion to be able to do that? That could have some adverse effects for one or all defined plans and for the entire PBGC program as a whole. It certainly would not be of benefit to the steelworkers or other people who are covered by the program.

Mr. DUZAK. Well, I think that you have to—I would have to respond to that in two ways.

First of all, if you talked about the threat to the system entirely, I think most people would agree that if the economy worsened considerably and we got into a position where there were massive bankruptcies involving substantial employers—auto companies, steel companies—terminations of plans involving millions or hundreds of millions of dollars, or more, of unfunded guaranteed benefits, certainly that is a question or a threat that really deserves consideration, maybe in a slightly different context.

Senator NICKLES. So what you are really saying is, yes, you agree that we may need to do something but you would like to see it isolated on title VI?

Mr. DUZAK. I think the specific proposal that we are considering now is S. 1541. Massive plan terminations across the country are not prevented by enactment of S. 1541. Certainly that involves the economy, the future that is hard to predict. But with respect to the changes proposed in S. 1541, we did hear the testimony of Mr. Nagle and of the administration, and we note that, even at this point in time, they have not really quantified what kind of premium increase would be necessary with or without the enactment of the legislation. Most of the speculation concerning what might happen without enactment of S. 1541 focuses on more or less a worst-case scenario, and the testimony talked about if these 30 major plans were to terminate, what would happen? We do not believe that it is absolutely a fact that these plans are going to terminate. We certainly do not expect that.

Senator NICKLES. Say we have a competitive industry here, maybe they are covered by collective bargaining plans so they all have similar pension liabilities. Let us take the example as it may affect the steelworkers—if we had a situation like that and they are in somewhat of the straits so they dumped, but were able to continue business, PBGC picked up the liabilities, and they continued in existence. There is a competitor over here and they are having a hard time keeping their heads above water; do you not see a possible phenomenal effect? We had testimony from the administration and others that said, yes, we need to change it legislatively.

Mr. DUZAK. Well, maybe we might have had some foresight, in fact, in negotiations with the steel industry. We have prevented the steel industry from dumping upon the system. They have a very clear contract with the union which would absolutely prohibit them from making the kinds of changes that would be considered dumping, that would be necessary in order to dump onto the system. I think it has to be recognized that not every employer in this category of having low net worth is in a position to simply walk in tomorrow and dump onto the system. There are a lot of other factors that need to be considered.

Senator NICKLES. I know you represent the steelworkers, and the steelworkers have contracts with a lot of companies.

Mr. DUZAK. Thousands.

Senator NICKLES. In general, are the companies that you negotiate with the major companies, U.S. Steel and some of these others, are their pension plans in pretty good shape?

Mr. DUZAK. I think it varies. It varies.

Senator NICKLES. Let us say U.S. Steel is in good shape. I have heard that they have large assets in their pension plans.

Let us say we have a company that has a good pension fund, has done their homework, paid the rates as they should have for years and years, and are in pretty good shape. Regardless of what the current economy is, they put their money in and they paid the price. If we do not somewhat tighten the system up to eliminate the abuse and the potential for abuse, are we not more or less saying maybe you have some people dumping and some people falling on hard times? You have survival of the fittest where that good employer is not only paying for the pensions of his employees, but now he has to take a liability of some of the employers who did not do their homework?

Mr. **Duzak**. I could remember some years ago before ERISA was passed, a large number of employers objected to this because they felt it would help poorly funded plans, and now they have good plans and they should not bear the cost of the systems. That proposal, that suggestion or argument was absolutely rejected by Congress when it enacted title IV. Certainly the record of the United Steelworkers is absolutely clear as being probably representative of the staunchest advocates of a strong pension system, and a strong termination insurance system. And we are not opposing this legislation because we are opposed to maintaining a good insurance system. We are opposing the legislation today because, one, we think that many aspects of it that would amend title IV are detrimental to the needs, or are contrary to the needs, of workers whom we represent, and also we think that it is untimely. We think if the worst case does arise, and it is clear through the courts that there is a loophole and that employers are taking advantage of it, and that we know exactly what the exposure is, and what is going to maintain that system in terms of a premium increase. Then, as our testimony indicates, at that point in time we certainly will be here offering suggestions on how to maintain a solvent system.

Senator **Nickles**. On the timely question, ERISA was passed in 1974 primarily for single employers. We had the PBGC in charge of administering the program that changes need to be made and they need to be paid now. I do not think it is just contingent on worst case scenario. I think, as the law exists today, that we are going to have to have substantial increases today. There is a deficit of $100 to $200 million as it stands today and there is also, as you are well aware, existing cases which could increase that liability considerably. So we just did something; the only thing we just did was in multiemployers in 1980. We are not discussing the multiemployers' termination in this bill.

Mr. **Sheehan**. Mr. Chairman, may I make some comments in relation to that question and then perhaps something you have said?

Certainly the PBGC representative in talking about increases in the future used the word that there would be modest increases. He did not want to be pinned down as to the exact amounts. He did say that without the legislation, that with changing the insurable events, that they would have to take a look at that situation. He did say that there might be some drastic increases there.

But, without that, he really was talking about modest increases in premiums, and I must say that as far as the union is concerned, increases in the premiums are certainly what we would contemplate in the whole program. We are not opposed to premium increases because we are ascertaining that if there are pension plans that do go bankrupt, that the premium system in this country should take care of that. And so to that extent our position may be quite different from others with regard to premium increase. We are not opposed to them, and if they are necessary, unfortunately necessary, we support them. But the other point I wanted to get at is that we ought to make some distinctions here as to what type of a problem we are talking about.

If indeed, Senator, that we are going to have major collapses in this country due to a depression, hopefully this pension protection will take care of those workers whose companies default because of the economic conditions in the country. We have had major steel companies or some steel companies that have already defaulted and are now being protected, their workers are being protected because of this plan. Here we have an economic situation and a company goes under.

I would, as Tom has indicated to you, that if we are moving into those kinds of situations which major automobile companies would be going under in this country, major steel companies would be going under, we would be driving towards a major change, policy change in this country. I think that is where the answer to those kinds of problems are.

You will not find the answers in S. 1541 because they do not address themselves to plant shutdowns in the country. We are not talking about companies that are failing to meet their funding obligations, and I think you had a line of questioning there about the good employer and the bad employer and the bad guy underfunding. And why should he dump these onto the system? That again is not what we are talking about. It is not the problem that we are addressing or that S. 1541 is addressing itself to because the ERISA legislation requires all these plans to be properly funded.

We are talking about a situation where perhaps plans that are meeting their funding requirement under the act nevertheless would move to terminate. And as Tom had indicated to you, that movement on their part is not as entirely voluntary as some of the testimony this morning seemed to indicate.

Senator NICKLES. Gentlemen, we appreciate your input. You made some other comments on other sections of the bill, reporting, disclosure and some others, and it is our intention to move with this bill. We intend to have additional hearings in the first part of next year so we are talking about a couple of months to do more homework. I have never stated that I thought the bill as introduced is what we will come out with in this committee, so we solicit your input for some possible changes to make it more acceptable not only to you, but to the workers. It is our intent with this legislation to improve a program that was started in 1974 designed to protect workers, their future benefits, we think, and I believe the testimony has indicated that some refinements and adjustments need to be made. It is with those changes to further protect the pensions and future benefits for the workers of America, it is the reason why we are trying to address this legislation.

I think our goals are common and we would appreciate your further input. Thank you.

Our next guest is Jim Treacy, chairman and chief executive officer, Facet Enterprises.

Also we would like to enter into the record a statement by Senator Carl Levin.

[The following was received for the record:]

TESTIMONY OF SENATOR CARL LEVIN

on S. 1541,

The Retirement Income Incentives and
Administrative Simplification Act of 1981

Mr. Chairman:

I want to thank the Committee for giving me this opportunity to testify in favor of amending S. 1541 to include a provision which would allow a business to terminate a single-employer pension plan and adopt new plans which would be financed in part by the Pension Benefit Guaranty Corporation (PBGC) if that business was established pursuant to an order of the Federal Trade Commission. This amendment would affect the case of Facet Enterprises, which is headquartered in Tulsa, Oklahoma and has about 700 employees in the Detroit area. I along with Senators Boren, Moynihan and D'Amato have introduced legislation, S. 1835, which embodies this amendment, and I would ask the Committee to consider it standing on its own, if the Committee does not choose to include it as part of S. 1541.

I ask that the Committee support this legislation in order to accommodate Facet's situation because although the PBGC and Facet are currently attempting to negotiate a settlement, it is uncertain at this point whether they will be able to reach an agreement. While these negotiations continue, the financial future of Facet remains precarious and the jobs of 700 of my constituents hang in the balance.

I would like to take a moment to describe the background of the Facet situation in order to point out the equitable considerations which argue strongly in favor of providing Facet with legislative relief.

In 1974, the Federal Trade Commission (FTC) issued a consent order directing that the Bendix Corporation first organize and then divest itself of a new company composed of various Bendix operations in the automotive filter business. The divesture took place on April 1, 1976, and the new company's name was Facet Enterprises, Inc.

Facet was assigned $52 million in unfunded pension liabilities relating to unionized employees who worked in the Bendix divisions that became Facet. Because of the inherited pension liabilities, Facet was placed in a serious financial situation which continues to the present time.

In 1980, Facet and the United Auto Workers, the union representing the employees, agreed that Facet's current pension plan was too costly, and, therefore, that it should be terminated. On November 13, 1980, Facet served the PBGC with the legally required notice that it terminated the pension plan. In its place, the two new pension plans were accepted by Facet to cover workers who had been covered by the terminated plan.

In an effort not to jeopardize the termination of the pre-November 13 pension plan, Facet's counsel presented the matter to the PBGC in early December 1980, and asked for a ruling regarding the adoption of the new plans that were being proposed and the effect it would have on the termination of the pre-November 13 plan. In January 1981, the PBGC indicated that the proposed new plans could not be adopted along with the termination of the pre-November 13 plan. Facet revised the proposed plans in an effort to the PBGC's objections.

On April 3, 1981, the PBGC said that the revised proposal would not be acceptable, and in response, Facet again revised the proposal. On April 24, the PBGC sent a letter to Facet stating that the termination of the pre-November 13 plan was "legally ineffective," but made no reference to Facet's latest revision of its proposed new pension plans which had been submitted to the PBGC earlier that month. Facet's counsel had, therefore, been in contact with the PBGC for over five months, but this was the first time that such a statement was made regarding the termination.

In reviewing the facts of this situation, there are equitable grounds for relief. Facet was established pursuant to an order of a governmental agency and was immediately presented with an unfunded pension liability which from the very beginning jeopardized its financial future. Facet, then, had the "choice" of modifying its pension arrangements or filing for bankruptcy. Furthermore, Facet did not receive timely notice from the PBGC that these modifications and revised modifications were "legally ineffective" even though Facet had conscientiously kept the PBGC informed of its actions with respect to all the pension plans.

It just seems to me that after mandating the creation of Facet and then afflicting it with a handicap at birth which threatens its continued existance, the federal government should do whatever it reasonably can to help it survive financially. The legislation which we are asking the Committee to consider will provide this assistance. Otherwise, Facet will be strangled at birth by bureaucratic fiat.

Senator NICKLES. I might mention to our guests we have four additional panelists. We also have some work that is going to be going on so we have to move in fairly rapid form. I might tell you and the rest of the guests I have read your statements and they will be entered into the record in full and in your case particularly, Mr. Treacy, you have gone into a great detail of the history of your problems with PBGC. You informed Mr. Nagle that you had some kind comments regarding his agency, but your entire statement will be entered into the record. And I would like, if you would, to maybe pass or make a quick summary of those if you would like, and then I would like to ask you some pertinent questions dealing with the legislation that is before us today.

STATEMENT OF JAMES B. TREACY, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, FACET ENTERPRISES, INC., TULSA, OKLA., ACCOMPANIED BY JAMES R. MALONE, PRESIDENT AND CHIEF OPERATING OFFICER; HARRIS WEINSTEIN, ESQ., COUNSEL; AND JOHN VINE, ESQ., COUNSEL, COVINGTON & BURLING

Mr. TREACY. Yes, sir. Senator, I would like to inform you that here at the table with me we have legal counsel, Mr. Harris Weinstein and Mr. John Vine of the firm of Covington & Burling, and the president of Facet, chief operating officer, Jim Malone.

Senator, we are here today to respond to your request that I testify before this subcommittee regarding the history and present status of Facet's pension problems. I will read a summary and not the complete statement.

Facet was organized in 1975 as a wholly owned subsidiary of the Bendix Corp., and was spun off as an independent publicly owned company effective April 1, 1976, as a stock dividend to Bendix shareholders. A 1974 consent decree between the FTC and Bendix had required Bendix to establish Facet as an independent competitor.

We are not a large company—our annual sales for the fiscal year ending September 30, 1980, were $134 million.

Our headquarters are in Tulsa, Okla. Most of our 2,600 employees are in Michigan, Missouri, New York, Oklahoma, North Carolina and Utah. Our principal products include automotive products, filtration products, and environmental waste treatment equipment.

Throughout our existence, our most significant business problem has been the unfunded vested pension liabilities that the FTC permitted Bendix to assign to us upon our creation. Those unfunded vested liabilities amounted to approximately $52 million. We started with $70 million in vested pension liabilities and $18 million of assets in our pension trusts. We inherited a 6-year pension agreement negotiated between the UAW and Bendix and were not permitted to participate in any of the negotiations. While three pension plans are involved, most of the unfunded vested liabilities are attributable to a pension plan governed by a collective bargaining agreement with UAW. That plan is the hourly employees' pension plan, which I shall refer to as the hourly plan.

After years of unsuccessfully seeking the intervention of the responsible agencies of the Federal Government—and after a successful settlement of a suit we brought against Bendix—business circumstances compelled us to terminate the hourly plan. Tomorrow, in fact, will be precisely 1 year from the effective date of the termination.

Our efforts to secure assistance from the responsible Federal agencies began on the day of the spinoff from Bendix—April 1, 1976. Because the FTC had failed to address the pension problem in the course of the divestiture it required of Bendix, we spent over 2½ years trying to persuade the FTC to reopen the matter. The FTC refused to do that and also refused to say why. It never sought to defend its mismanagement of the divestiture but simply washed its hands of the matter.

We also went to the Pension Benefit Guaranty Corporation in April 1976, asking it to determine that the original Bendix pension plan from which our plans were derived had been legally terminated at the time these liabilities were assigned to Facet. Our counsel were satisfied that the PBGC had the power to take this action. The result would have been to require Bendix to reassume responsibility for the portion of the liabilities attributable to past service of Bendix's covered employees and retirees. The PBGC, after considering the matter for the better part of 2 years, refused to act. Later, when we sued Bendix and asked the PBGC to intervene on our behalf, the PBGC again refused to help.

The third Federal agency, the Internal Revenue Service, did give us some relief, and our lawsuit ultimately persuaded Bendix to consent to an IRS ruling that resulted in a transfer of an additional $14.7 million to our pension plan trusts; $13 million of that amount went to the hourly plan. Unhappily, the IRS could grant no further relief, because its powers were limited by the funding level of the original Bendix pension plans, and prior law had not required Bendix to fund those plans fully.

When it became clear in 1978 that the Federal agencies having responsibility in this area were not going to help us, we instructed our counsel to take direct action against Bendix. We sued Bendix in the Delaware Chancery Court in December 1978.

As spelled out in our written statement, we negotiated a favorable settlement of that lawsuit. We added almost $15 million in assets to our pension trust funds and received additional consideration. Those millions of dollars all reduced the PBGC's exposure to loss under its pension termination insurance program.

Unforeseen adverse business conditions and increases in the prime rate hit us very hard over the following year. During the lifetime of Facet, we have contributed over $20 million to the pension trusts. Most of that money was borrowed at very expensive interest rates.

Our 1980 negotiations with the UAW gave us our opportunity to address the pension problem with our union. We had no choice but to terminate the hourly plan. We did so effective November 13, 1980. After lengthy and serious negotiations with the UAW, they agreed not to oppose the termination.

For reasons that have never been fully explained, the PBGC has refused to recognize the termination. We have been forced to sue the PBGC, so once again we are involved in expensive litigation. We have made every effort to resolve our problem through negotiation, and have not been able to do so.

We urge the Congress to enact an amendment to the law that would make clear that Congress intended that a company in Facet's unique position be able to terminate its pension plan. Otherwise we will be forced to continue to devote more money and time to the litigation that the Government has forced on us. We are only asking that the Federal Government, which was an originator of our problem, apply ERISA to us in the way the language of the law requires.

Earlier this week, four Senators, in a bipartisan act, introduced such a bill, S. 1835. We hope the Congress will act favorably on that bill in the near future.

Thank you.

[The prepared statement of Mr. Treacy follows:]

BEFORE THE LABOR SUBCOMMITTEE
OF THE
COMMITTEE ON LABOR AND HUMAN RESOURCES OF
THE UNITED STATES SENATE
TESTIMONY OF JAMES B. TREACY,
CHAIRMAN AND CHIEF EXECUTIVE OFFICER,
FACET ENTERPRISES, INC.
TULSA, OKLAHOMA

NOVEMBER 12, 1981

I am here today in response to Senator Nickles' request that Facet provide this Subcommittee with first hand information about the history and present status of Facet's pension problems.

The Origin of Facet and Its Pension Problem

Facet is a relatively small, publicly held company headquartered in Tulsa, Oklahoma. Our sales for the fiscal year ending September 30, 1980 were $134 million. Facet's products include automotive components, filtration products, environmental waste treatment equipment and recreation products. We employ 2,600 people. Most of our employees work in manufacturing and distribution facilities in Michigan, Missouri, New York, Oklahoma, North Carolina, and Utah. We also have some employees in each of California, Connecticut and Tennessee.

Facet was created in 1975 as a result of a consent decree that the Bendix Corporation had entered into with the Federal Trade Commission in 1974. A copy of the consent decree is attached to my testimony.

Facet was first established as a wholly owned Bendix subsidiary composed of various Bendix operations. Bendix spun off Facet as an independent, publicly owned corporation, effective April 1, 1976.

For the first full four fiscal years after Facet became independent, our aggregate after tax loss was over $3 million. Our losses would have been even greater without a favorable settlement of a lawsuit we brought against Bendix, which I shall describe later.

Before the spinoff Facet assumed vested pension liabilities under three pension plans that amounted to approximately $70 million. To fund those liabilities, Bendix transferred some $18 to Facet's pension trusts, leaving $52 million in unfunded vested liabilities. Most of the liabilities with which we are concerned related to what is now known as Facet's Hourly Employees' Pension Plan ("The Hourly Plan"), and most of the workers covered by the Hourly Plan never worked for Facet. This plan, which Facet had to terminate a year ago, was governed by a collective bargaining agreement with the UAW.

All of these basic arrangements were worked out before Facet was spun off. Although the FTC had jurisdiction of the divestiture process, it completely ignored the pension matter.

Facet's Efforts to Secure Relief from the Responsible Federal Agencies

When Facet became independent on April 1, 1976, I, together with other members of Facet's management, immediately moved to seek relief from what we knew would be an onerous burden for Facet.

Facet of course then had and still has quite limited resources. We in management knew that the Federal government, in forcing the creation of Facet, was a root cause of our pension difficulties. We thought it was only right and proper for the Federal government to take the lead in forcing action that would make Facet a viable enterprise. We were not looking for or expecting any special favor or federal handout. What we wanted was for the Federal government to do justice - to reverse the severe impediments to success that our huge pension costs had created.

Our efforts to persuade the responsible federal agencies to require Bendix to reassume the responsibility for a significant part of those liabilities consumed three and a half years. Throughout this period an enormous amount of the time of senior management was devoted to this comprehensive and vigorous effort.

On April 1, 1976 - the day the divestiture became effective - we called on the FTC to ask it to take action. Despite intense efforts by us and our counsel over more than two years, the FTC refused to take any action whatever. We ultimately insisted on a formal decision, and in September 1978 the FTC voted unanimously to refuse to reopen the matter.

The FTC was not the only federal agency from which we sought relief. We asked the Internal Revenue Service to review the apportionment of assets between the Bendix and Facet pension plans. We asked the Pension Benefit Guaranty Corporation to make Bendix responsible for the unfunded liabilities attributable to service the covered employees had performed for Bendix. We also urged the Department of Labor to assist.

The Internal Revenue Service eventually directed Bendix to transfer approximately $14.7 million more to Facet's pension trusts as a condition of preserving the tax qualification of Bendix's pension plans. The IRS gave this relief after the lawsuit Facet brought against Bendix persuaded Bendix to agree to concede certain matters in dispute at the IRS and not to appeal adverse determinations the IRS made on other questions. This relief was the maximum relief that the IRS had statutory authority to award.

The reason is that the powers of the IRS are limited to assuring an equitable division of assets between the Bendix and Facet pension plans. As applicable law had not required Bendix to fund its plans fully, the IRS could require only a limited additional transfer of assets to the Facet plans. Only the FTC and the PBGC had power to require Bendix to provide Facet with greater relief.

From the very beginning, Facet had strenuously urged the PBGC to step in. Facet specifically asked the PBGC to exercise its statutory authority under ERISA to terminate Bendix's pension plan retroactively as of a date prior to the effective date of Facet's divestiture. This action would have nullified the transfer of any of Bendix's pension liabilities to Facet, enabled the PBGC to recover its full cost of insuring those liabilities from Bendix's ample net worth, and eliminated totally the risks to both the PBGC and Facet of an eventual termination of any of Facet's pension plans. In 1976-1977, Facet stressed to the PBGC that the pension burden could ultimately erode Facet's financial resources to a point where Facet would be forced to terminate one or more of its pension plans. In late 1977, the PBGC decided not to act against Bendix.

Facet's Lawsuit Against Bendix

Once it was clear that the FTC and PBGC had decided to wash their hands of the matter, we instructed our legal counsel to pursue relief directly against Bendix. This was a difficult choice for us, because we knew we could not begin to match the financial resources Bendix would bring to the battle.

Facet filed suit against Bendix in the Delaware Chancery Court in December 1978. The complaint was based on an untested and uncertain legal theory -- that Bendix and its officers owed Facet certain fiduciary and other legal duties at the time when Facet was a wholly owned subsidiary of Bendix. At an early stage of its suit against Bendix, Facet once more approached the PBGC, requesting that the PBGC participate in the litigation on Facet's side. Again, the PBGC declined to act.

In October 1979, Facet and Bendix agreed to settle the lawsuit and all other differences between them. The PBGC received prompt notice of the settlement, and offered no comment. The settlement was finally consummated early in 1980. Our relationship with Bendix has since been without controversy, and we intend to keep it that way.

The settlement was an attractive business proposition to Facet and reduced the PBGC's potential exposure to claims under Facet's pension plans by millions of dollars. Under that settlement, Bendix agreed to abandon its position before the IRS, which ensured the prompt receipt by Facet's pension trusts of $14.7 million in additional assets. Of this amount, some $13 million went to fund the Hourly Plan. Bendix agreed to pay Facet directly an additional $4.3 million of which $1.5 million was a nontaxable capital contribution. By agreeing to enter into an attractive ongoing business relationship with Facet and to give Facet other consideration, Bendix added further to the economic value of the settlement.

Although the settlement did not provide full relief from Facet's pension liabilities, it added significantly to our pretax earnings for fiscal 1979 and permanently reduced the annual cost of funding our pension plans by over $1 million per year. The cash paid directly to Facet helped us keep our borrowings within the limits established by our revolving loan agreement with three major banks. The settlement also eliminated the uncertainties, delays and legal costs associated with prolonged litigation, and allowed Facet's management to focus on running the company's business without the diversion of legal proceedings.

Facet's management, moreover, was convinced that Facet was unlikely to survive the period of years required to obtain a final resolution of the matter in court. Economic conditions at the time - October 1979 - looked promising to us, and we believed - wrongly as it turned out - that the Bendix settlement would allow Facet to remain healthy while maintaining the pension plans.

Termination of the Hourly Plan

As Facet conducted contract negotiations with the UAW in 1980, Facet's management concluded that Facet could not survive intact if Facet's Hourly Plan continued. Economic conditions had rapidly deteriorated as 1980 came and progressed. We had to shut down one new venture and restructure and substantially change another. Sharply decreased auto sales were particularly hurtful. Unanticipated increases in the prime rate hit us with special force. We were heading toward an inescapable default on an important convenant of our vital revolving loan agreement. Accordingly, terminating that plan became a matter of highest priority for Facet. We explored all other possibilities - including freezing the Hourly Plan and seeking temporary funding waivers from the IRS - and found they would not work. The only feasible alternative to what we did was to shut down the plants in New York, Michigan and North Carolina, which are the ones affected by the Houly Plan costs.

After extended negotiations, Facet reached agreement with the UAW on November 12, 1980. That agreement recognized that Facet would terminate the Hourly Plan. Facet had already taken the legal steps required to effect this termination on November 13, 1980 by giving the PBGC prior written notice of its intent to do so.

Facet's November 12 labor agreement provisionally called for adoption of new pension plans to cover persons previously covered by the terminated Hourly Plan. Because of Facet's need to terminate that Hourly Plan without legal or other complications, the November 12 labor agreement made adoption of the proposed plans contingent upon a determination that such action would not adversely affect the termination of the Hourly Plan. Facet has not as yet adopted the proposed plans or any other plan or plans respecting employees who had been covered by the Hourly Plan prior to its termination.

The PBGC's Response

On December 9, 1980, Facet's attorneys met with an attorney on the staff of the PBGC General Counsel's office. They provided him with copies of Facet's agreement with the UAW and with an outline of the proposed new plans and requested that the PBGC issue an opinion that the proposed plans would not adversely affect the termination of the Hourly Plan. On December 22, 1980, in response to a PBGC attorney's request, Facet submitted a written request for the PBGC's opinion. On December 31, 1980, Facet submitted a letter to the PBGC addressing several issues that had been raised orally by the PBGC attorney.

On January 16, 1981, the PBGC attorney advised Facet's counsel by telephone that the PBGC believed that the proposed new plans would adversely affect the termination of the Hourly Plan. The same conclusion was reiterated in a conference with the PBGC's General Counsel on January 21, 1981.

In response, Facet, on January 23, 1981, proposed an alternative, and more limited, new plan.

On April 3, 1981, the Executive Director of the PBGC orally advised Facet of his opinion that the Hourly Plan's termination would be adversely affected if Facet adopted the alternative proposal of January 23. Facet proposed further revisions, which were confirmed by a letter of April 6, 1971.

On April 24, Facet's counsel received a letter from the PBGC's Executive Director. That letter asserted for the first time that Facet's November 13, 1980 termination of the Hourly Plan was legally ineffective. That letter also indicated that the PBGC intended to scrutinize the history of the Facet-Bendix relationship and that it had "questions" about the settlement of the Facet-Bendix litigation.

The April 24 letter relied principally on the proposed new pension plan described in Facet's November 1980 agreement with the UAW in arguing that the termination was ineffective. The letter, however, made no mention of, and offered no opinion on, the revised plans proposed to the PBGC in April 1981. nor did the letter acknowledge that the PBGC had in 1976-1977 refused to act directly to aid Facet, had in 1979 refused to assist Facet in its lawsuit against Bendix, had in October 1979 received prompt notice of Facet's settlement with Bendix, and had never before raised the slightest question about that settlement.

On April 29, 1981, Facet filed suit against the PBGC in the United States District Court for the Northern District of Oklahoma, seeking a declaratory judgment that the Hourly Plan had been terminated on November 13, 1980 and an injunction compelling the PBGC to implement the termination of the Hourly Plan.

After filing suit, we continued our efforts to resolve this matter without further litigation. We worked hard at that effort for several months, but have failed. Moreover, during this period the PBGC announced a new adverse position: a claim that Facet's management had an improper purpose in terminating the Hourly Plan. That contention is the legal equivalent of arguing that even if termination of the Hourly Plan is legally recognized, the PBGC should not insure substantial pension benefits that Bendix and the UAW agreed to in 1974 but which did not become effective until April 1, 1976 and later.

Some Observations

We and our counsel believe there is no legal basis for the claim of the PBGC's Executive Director that Facet's Hourly Plan has not been terminated. Facet followed all requirements of law in effecting the termination. The PBGC has made no effort even to suggest that some legal requirement attending termination has been overlooked by Facet.

Also the factual basis for the position taken in the Executive Director's letter of April 24, 1981 is deficient. That letter is based on the apparent premise that Facet had adopted or was committed to adopt the proposed new plans described in Facet's November 12, 1980 agreement with the UAW. In fact, however, Facet has not at any time adopted any new plan, and the November 12 agreement expressly recognizes that Facet will not adopt any new plan that adversely affects the termination of the Hourly Plan.

Our counsel has advised us that ERISA specifically provides that conversion of a defined benefit plan to an individual account plan automatically terminates any predecessor, defined benefit plan. The proposed target benefit plan described in Facet's letter of April 6, 1981 to the PBGC is an individual account plan.

The Executive Director's letter of April 24, 1981 refers to "questions concerning the appropriateness of Bendix's original transfer of liabilities to the Hourly Plan and the manner in which that issue was resolved in the Bendix-Facet settlement." As of April 24, 1981, over five years had passed since the PBGC was first informed of the original transfer of liabilities, over two years had passed since the PBGC declined to participate in Facet's lawsuit against Bendix, and over 18 months had passed since the PBGC was informed of the terms of Facet's settlement with Bendix. Facet has for over five years answered every question the PBGC has had about this matter, and has volunteered whatever further information Facet considered pertinent to the matter at hand. If the PBGC truly has relevant questions that it believes have not been answered, it should at the very least have set forth those questions in the Executive Director's letter of April 24, 1981. As far as our settlement with Bendix is concerned, we fought the best fight our resources and our legal position allowed, and we got the best settlement that we could. We have made our peace with Bendix, and we should not be second-guessed now by an agency that refused to act over a 3 1/2 year period starting in April 1976.

Persistent refusal by the PBGC to recognize the termination of the Hourly Plan will be self-defeating. If Facet is forced into insolvency, the PBGC's liabilities will be increased because all of Facet's pension plans -- not just the Hourly Plan -- will then become the PBGC's responsibility.

It is absurd for anyone to suggest that Facet did not have proper business reasons for terminating the Hourly Plan. We fought for years to maintain the Hourly Plan. No one should ignore the harsh reality expressed by a UAW official who in April 1981 was quoted in the Tulsa World as saying that the costs of the Hourly Plan, had it not been terminated, "probably would have sunk the whole damn company."

Litigation with the PBGC may be a legal answer, but is not a practical answer for Facet. Because the PBGC refused to act when it could have compelled Bendix to reassume substantial liabilities, Facet has been forced to incur sizable legal fees and the officers of Facet have been forced to devote to this matter enormous amounts of time that could better have been invested in building Facet's businesses for the future. Now, the refusal of the PBGC to act lawfully on the basis of the facts before it threatens Facet with years of litigation and thousands of dollars in legal costs. Money and time are precious to Facet. Facet should not be forced to choose between costly and time-consuming litigation on the one hand and an impossible pension burden on the other.

For these reasons we respectfully urge the Congress to adopt legislation specifically addressed to Facet's situation. We are firmly convinced that Congress intended the PBGC's pension termination insurance program to apply in our circumstances. Of equal importance, our problems were created for us by the FTC, an arm of the Federal government, and our immediate difficulties are caused by the refusal of the PBGC to act in accordance with the governing law. Much has been said over the last few years of the ways in which Federal regulators are choking American business. Facet is a dramatic example of that phenomenon. The PBGC would apparently prefer to force us to liquidate sizable portions of our business - and to terminate hundreds of jobs - rather than provide the insurance coverage that ERISA established and for which we have paid premiums ever since Facet's formation. It now appears to us that only the Congress can take the action required.

Senator NICKLES. Thank you very much, Mr. Treacy. I have a couple of comments and we will probably have additional questions, too.

Is there any other company you know that the FTC has forced or obligated a divestiture of which that divestiture was such that the company spun off had an exorbitant amount of pensions, unfunded pension liability?

Mr. TREACY. To the best of my knowledge, Senator, no, I think we are absolutely unique in American business history in that respect.

Senator NICKLES. How much money are we talking about? How much unfunded liability would be going to PBGC if the plan is terminated and they took 30 percent of your assets? What is the net figure? What are you talking about to the liability of PBGC?

Mr. TREACY. That, of course, depends on the ultimate determination of our net worth. Whatever the 30 percent results in will offset the total amount.

Senator NICKLES. What is the total amount of liability?

Mr. TREACY. Well, anticipating that question, I do have a little calculation here.

If the PBGC's interest rate assumptions from last November are used, the unfunded vested liabilities are about $19 million. If more current interest rates are used to determine the earnings of the trust fund, the cost to the PBGC is about $9 to $9.5 million. We think that is the more realistic measure.

Senator NICKLES. So the liability of PBGC on historical interest rates would be around $19 million, and under 14 percent assumption or something in that neighborhood, you are talking about $9 million?

Mr. TREACY. Yes. I think we used the 9-percent interest assumption in calculating the $19 million, which is a pretty low interest rate by today's standards.

Senator NICKLES. The hourly plan that you have terminated, PBGC is saying, no, you cannot terminate, that is in dispute, was a pension plan with your hourly workers that were represented by United Auto Workers?

Mr. TREACY. Yes, sir. We inherited three divisions of Bendix who were part of a larger pension program that had 11 participating divisions, I believe, and when we were initially spun off, we got about 6 percent of the assets of that fund and about 30 percent of the liabilities, to my recollection.

Senator NICKLES. Five percent of the assets and 30 percent of the liabilities?

Mr. TREACY. Of that particular plan. Subsequent to that, when we sued Bendix and they put in another almost $15 million, that changed, that increased the assets in the trust fund. As a matter of fact——

Senator NICKLES. You have 30-some percent of the liabilities. Did you receive 30 percent of the assets?

Mr. TREACY. Oh, no—yes, we got the maximum the law allows, and I do not know what percent of their total assets it was.

Senator NICKLES. You are talking from the IRS?

Mr. TREACY. Yes.

Senator NICKLES. Or to Bendix?

Mr. **Treacy**. No; the IRS action that they took ordered the Bendix trust fund to pay to our trust fund the maximum amount that the IRS had authority to require, I think.

Senator **Nickles**. Was that a comparable percentage? They figured here is the total number of employees, total number of assets and liabilities, and make equal ratios on that with Bendix and Facet?

Mr. **Treacy**. I would like John Vine, who is an expert on that, to answer this.

Mr. **Vine**. There is a complex provision in the law that governs how you allocate assets when you spin off a plan. It is not simply on the basis of the amount of employees or simply on the basis of the number of liabilities, but the liabilities are ordered in a certain way and the assets are allocated along with the liabilities. The Internal Revenue Service required Bendix to reallocate the assets on the basis of that statute.

Senator **Nickles**. From that you received the maximum you could under present law?

Mr. **Vine**. Under present law, that is correct, Senator.

Senator **Nickles**. You are pleased with the IRS action? You got all the help you could from that but you are a little less than pleased from the FTC?

Mr. **Vine**. That is correct. All that the IRS had the authority to do was to allocate the existing assets.

Senator **Nickles**. Your interpretation of the present law is you have the legal right to terminate your plan and have PBGC pick up the liabilities from that termination?

Mr. **Treacy**. We have the legal right, we believe we have the legal right to do what we did, but I can say that a company does not surrender 30 percent of its net worth as a frivolous act.

Senator **Nickles**. What is 30 percent of Facet?

Mr. **Treacy**. Whatever that part—the court action is involved and there are negotiations with the PBGC to try to determine what that net worth is.

Senator **Nickles**. How much do your assets exceed your liabilities?

Mr. **Treacy**. It is net worth and not assets, but the———

Senator **Nickles**. Assets over liabilities. Do you have a ballpark guesstimate of what your net worth is?

Mr. **Treacy**. Well, our annual report which we put out last year, the footnote to the pension—regarding the pension problem says our net worth—30 percent of our net worth is somewhere between $4 and $14 million depending upon the method used to measure it. The value of our stock, if used, the public traded value of our stock would be—would result in about $4.1 million, and book value would result in some higher number, approximately $14 million. In previous cases we were told by the PBGC that they had used stock value to value net worth, and the generally accepted accounting principles required us to use $4.084 million.

Senator **Nickles**. If you use the book value figure, you are not that far away from paying or amortizing PBGC's liability, if their liability is somewhere in the neighborhood—well, that was net. That $9 to $19 million was after you subtracted your 30 percent?

Mr. **Treacy**. Yes—no; it was not. No; it was not.

Senator **Nickles**. Well, if it is $9 million, and 30 percent of your net worth would be $14 million, then there would be no PBGC claim whatsoever, liability?

Mr. **Weinstein**. Senator, the PBGC claims the $19 million is the figure that should be used; that is not based on what we think are realistic assumptions. I do not think there is any question if you tried to do that—it is more like $9 or $9½ million. The PBGC, however, says that is not what their rules are, and it is not how it should be done.

Senator **Nickles**. Let us say it is $10 million. I can see the discrepancies between the valuations on the interest rates; that is easy to figure.

But if 30 percent of net came up, it could go all the way up to $14 million. Let us say there would be no PBGC liability, is that correct?

Mr. **Weinstein**. It could work out that way. The issue is how does one measure net worth and how does one measure the unfunded liabilities?

Senator **Nickles**. You intended, or you made an agreement or summed up a provision with the auto workers to terminate this plan and replace it with a defined contribution plan?

Mr. **Treacy**. Part of the agreement with the UAW was that we would try to cover the pension requirements of the workers with a plan but the nature of the plan would have to be so it did not in any way interfere with the termination of the existing plan. We received notification from the PBGC that they did not agree we had terminated the plan because we had introduced a new plan which effectively provided the same benefits, and the facts are it is not true. We have never introduced any plan.

We have given the PBGC three different suggestions, but never adopted any—the most recent one they got shortly before they wrote us the letter and said because you have adopted those plans, we do not agree you terminated the old one. And the facts are, as of today, we have not done that.

Senator **Nickles**. How does the plan that you had intended or somewhat negotiated as a replacement, compare with the plan that was terminated?

Mr. **Treacy**. It would have been a guaranteed contributions plan but not a guaranteed benefits plan.

Senator **Nickles**. So defined contribution plan?

Mr. **Treacy**. Yes.

Senator **Nickles**. Percentage of compensation, or how is that?

Mr. **Treacy**. Well, from our point of view, we would like to protect the pensions of the workers and the retirees to the maximum extent possible. And I think the first plans that we submitted would effectively have done that, but we made changes to those plans or suggested changes to those plans but have not received yet from the PBGC any indication of what would be acceptable. We did not get any response to the request.

Senator **Nickles**. But the basic thrust of the plan was a defined contribution plan trying to come up fairly close to the value of the plan that was terminated?

Mr. **Treacy**. That was the original intent; but we will apparently not be able to do that.

Senator NICKLES. Why should PBGC or all the employees of the country pick up all the liabilities in the old plan? Then you come up with a new plan that is going to have somewhat similar liabilities down the road, if it is a defined benefits plan, PBGC could be liable for it again? I am just trying to see how that could be equitable.

Mr. TREACY. I think the alternative to that would be bankruptcy of the company which would result in termination of two additional plans which would have added to the cost of the PBGC, put 2,600 people on the street without jobs, and cost the PBGC more money because they would pay the same amount on the hourly plan anyway.

Senator NICKLES. If you do not terminate that plan, bankruptcy is imminent, and the plans will be terminated in a short while anyway.

Mr. TREACY. The result of bankruptcy would have been plan termination, that is right.

Senator NICKLES. And bankruptcy is inevitable if you do not have planned———

Mr. TREACY. At the time we made the business analysis leading to that difficult decision on our part, it indicated that we could not make it and continue to carry the cost of those plans.

Senator NICKLES. Is that still your thinking today? If you are successful in your suit against PBGC in suing for termination of your plan which you filed for a year ago, or intended to do and thought you had actually done a year ago, then bankruptcy is around the corner?

Mr. TREACY. Well, I hesitate to say that bankruptcy is around the corner.

Certainly at the time we did it, it would look like we would be, and we had very complex series of financial calculations and statements to have to prepare before I would know that.

But one of the things was certain at the time: we were faced with a large pension contribution, we did not have the money to make it and we could not borrow it. We were at the limit of our bank's agreements. We tried very much to negotiate additional loan agreements and were unsuccessful. It was an emergency business decision to perpetuate the life of our company and make it a healthy one which is, we think, the reason why the FTC created us in the first place.

Senator NICKLES. Are all your employees covered by United Auto Workers?

Mr. TREACY. No, sir.

Senator NICKLES. Are all of them under the hourly plan?

Mr. TREACY. No, sir. The employees in three divisions of Facet that formerly belonged to Bendix were covered by this particular hourly plan. We have another hourly plan which is different from this one with the UAW covering some hourly workers.

Senator NICKLES. What kinds of health are the other two plans in?

Mr. TREACY. They are in excellent shape. We fund them ourselves and they were in reasonably good shape when we got them.

Senator NICKLES. You did not inherit the large liabilities from Bendix?

Mr. **Treacy**. No; one fund we started ourselves, that is the second hourly plan to cover hourly workers who were not covered at all. And then the salaried plan we inherited from Bendix and it was in reasonably good shape and still is.

Senator **Nickles**. Under the hourly plan that is in question or that you filed for the termination of, what is your average hourly rate? Do you happen to have that figure?

Mr. **Malone**. About $9 an hour.

Senator **Nickles**. What is your contribution to pension for those persons if you were to make it—your actuary would give you something you needed to fund in the plan——

Mr. **Malone**. In the old plan?

Senator **Nickles**. In the old plan.

Mr. **Malone**. In the old plan, the cost is in the area of $3 million a year. The cash contribution to that is different because of making up the difference, it is in excess of $5 million a year.

Senator **Nickles**. When you pay some plan contributions which is set up, is that so much per hour that is put in? Is that percentage of payroll?

Mr. **Malone**. On the new plan?

Senator **Nickles**. No; your plan that you tried to terminate. You said the annual cost is $4.8 million. What is your annual payroll for those employees?

Mr. **Malone**. That would be a guess that I would rather not hazard without having a calculator.

Senator **Nickles**. I would like to, for the record, if you would, a very brief synopsis of the plan that is under termination and also the plan that you were going to submit as the substitute after termination.

And, gentlemen, again, I will say thank you and we are sympathetic to the dilemma that FTC has put you in. It also puts us in somewhat of a dilemma. Thank you, and we will ask for those questions and possibly some others that will address the legislation that is introduced by Senator Levin also.

The next guest today is Hilary Miller, chairman of the board, AlloyTek, Inc.

STATEMENT OF HILARY B. MILLER, CHAIRMAN OF THE BOARD, ALLOYTEK, INC., NEW YORK, N.Y.

Mr. **Miller**. Good morning. I am Hilary B. Miller, Chairman of the board of AlloyTek, Inc.

AlloyTek is an aerospace manufacturing concern located in Grandville, Mich. AlloyTek has about 300 employees, substantially all of whom, until recently, participated in pension plans insured by the Pension Benefit Guaranty Corporation [PBGC]. Our experiences in terminating the pension plan in which most of our employees had participated have given us much practical knowledge about the pension plan termination provisions of the Employee Retirement Income Security Act of 1974. We have developed some views as to how we think this system should work, and we would like to share those views with you today, specifically concerning S. 1541.

To our knowledge, AlloyTek is the only going concern ever to terminate an insured pension plan and have its liability limited to something less than the plan asset insufficiency. One other company, Facet Enterprises, is presently suing PBGC over PBGC's authority to refuse to recognize such a termination.

If every company whose unfunded vested pension liabilities exceeded 30 percent of its net worth were to terminate its plan simultaneously, obviously the aggregate costs thrust upon the single employer program would be considerable. Mr. Erlenborn has stated that such exposure is in excess of $6 billion, although PBGC's own estimate, after recovery of the 30 percent of net worth employer liability, is only $4.1 billion.

We think that measuring the potential exposure of PBGC in this manner is analogous to assuming that all of the homes insured by a casualty insurance company burn down simultaneously and ignores a number of real obstacles which must be surmounted by plan sponsors who wish to terminate insufficient plans. First, the vast majority of the unfunded liabilities which comprise this exposure arise under collectively bargained plans. Measuring exposure in this manner requires the assumption that the sponsoring employer will obtain union cooperation or, at the least, acquiescence, in the termination of each collectively bargained plan. In AlloyTek's experience, the negotiations necessary to obtain union consent to plan termination are formidable. Second, an employer who terminates an insufficient plan presently can suffer the immediate expense and cash flow implications of parting with 30 percent of its net worth. This is a very stiff price to pay.

Perhaps the best indication of the inappropriateness of this reasoning is empirical evidence. In the 7-year history of ERISA, only two companies—AlloyTek and Facet—have actually sought to terminate insufficient plans and to have their liability limited by the 30 percent of net worth provision. We hope you will conclude from this that the floodgates of termination are not likely to open tomorrow. Certainly two terminations over 7 years are not a cause for panic, although PBGC seems to think so.

Even assuming, arguendo, the reality of this threat, there is no evidence to support a conclusion that the proposed change in title IV of ERISA will materially lessen PBGC's exposure. The practical effect of the change proposed by S. 1541 is to remove the 30-percent employer liability ceiling. In 1979, in a study conducted for PBGC of impacts of a proposed alternative to contingent employer liability insurance, Arthur Young & Co., a Big Eight accounting firm, properly concluded that terminations of insufficient plans were very rare events and that such terminations were most likely to occur in connection with the shutting down of the sponsor's business operations. Such shutting down was deemed most likely to occur when the sponsor had incurred long-term losses, generally with a relatively low or even negative net worth. In such cases, Arthur Young concluded, an increase in employer liability from 30 percent of net worth to 100 percent of net worth would pose a minor disincentive because net worth is likely to be very low or nonexistent, and the potential for recovery will be insignificant. In our own case, filing a petition under chapter 11 of the Bankruptcy Code was something we considered for the sole purpose of being relieved of our pension liability. With bankruptcy as the only voluntary source of relief, other employers will find that approach increasingly attractive, particularly if PBGC is relegated to the status of a general unsecured creditor. Jobs will be lost as a consequence. Accordingly, we emphasize that S. 1541 does not contain any provision which is likely to achieve the intended result of preserving the economics of the insurance system against terminations of insufficient plans in light of the PBGC commissioned study by Arthur Young & Co.

The legislative history of ERISA reminds us that, in its original consideration of the single employer plan termination insurance system, Congress gave careful thought to the level at which employer liability should be set. If employer liability were set at zero, reasoned Congress, then employers would be encouraged to make unreasonable benefit promises because they would never be accountable if they later proved unable to fund such benefits. On the other hand, if liability were fixed at 100 percent of net worth, employers would be discouraged from adopting and liberalizing benefits under pension plans. So, 30 percent was fixed as a compromise, reduced from 50 percent in the original House version of ERISA. Now, it seems to us, S. 1541 does as much as possible to ignore this original concern of Congress and discourage the formation of new pension plans and the liberalization of benefits under existing pension plans. Further, we think title VI of S. 1541 will remove only a very small portion of the system's inherent danger, while giving a false sense of security regarding enormous liabilities which remain a threat.

A solution which is hinted at by title VI, with which we strongly agree, is a significant tightening of minimum funding standards. One reason our company found termination necessary is that our predecessor employer—who had initiated our plan and adopted its funding policy—had adopted unrealistic funding policies in order to minimize pension cost.

To be specific, pre-ERISA liabilities were being amortized over 40 years. That is, of course, perfectly legal. But the average age of our employees was then 44. When one is 44, a period of 40 years is not only 19 years longer than the remaining period to normal retirement age, but also 11 years longer than one's life expectancy. That means, in other words, that a significant portion of our employees' pension benefits would still be unamortized even after most of the plan participants were deceased.

Unfunded liabilities should be amortized, in our view, over a period not longer than the remaining weighted worklife of the plan participants. This insures that each participant's benefit will be there when he retires.

Although we agree that some change may be appropriate, title VI of S. 1541 does little to reduce the attractiveness of voluntary plan termination for those truly strapped companies for whom such action might be desirable under current law. What the bill does is to force bankruptcy upon a company. Indeed, to the extent PBGC receives moneys, it will do so at the expense of unsecured creditors. This will result in a curtailment of trade credit to financially weak companies and almost guarantee a bankruptcy proceeding of which the PBGC will derive little, at the possible expense of jobs.

In summary, title VI of S. 1541 addresses what experience teaches is an illusory problem, at possibly grave cost to companies that might otherwise avoid bankruptcy. Instead, we suggest attacking the origin of the problem with an approach to funding that matches pension costs with employee service. In so doing, one can provide lower exposure for the private pension insurance system and impose on labor and management the obligation to bargain responsibly over pension liabilities in the knowledge that such liabilities must be paid during the careers of the current workforce.

Thank you.

[The prepared statement of Mr. Miller follows:]

STATEMENT OF
HILARY B. MILLER, CHAIRMAN OF THE BOARD OF ALLOYTEK, INC.
BEFORE THE SUBCOMMITTEE ON LABOR
OF THE SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES
CONCERNING TITLE VI OF S.1541
(RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE SIMPLIFICATION ACT OF 1981)

NOVEMBER 12, 1981

Thank you, Mr. Chairman and members of this committee, for the opportunity to speak with you today. I am Hilary B. Miller, Chairman of the Board of AlloyTek, Inc.

AlloyTek is an aerospace manufacturing concern located in Grandville, Michigan. AlloyTek has about 300 employees, substantially all of whom, until recently, participated in pension plans insured by the Pension Benefit Guaranty Corporation ("PBGC"). Our experiences in terminating the pension plan in which most of our employees had participated have given us much practical knowledge about the pension plan termination provisions of the Employee Retirement Income Security Act of 1974. We have developed some views as to how we think this system should work, and we would like to share those views with you today, specifically concerning S.1541.

Title VI of S.1541 restructures the single employer plan termination insurance provisions of Title IV of ERISA.

This restructuring follows principles supported by the PBGC in (a) changing the "insurable event" from plan termination to the liquidation of the sponsoring employer, and (b) requiring employers to continue funding vested benefits after plan termination. The purpose of such restructuring, as suggested by Congressman Erlenborn, the principal proponent of this legislation in the House of Representatives, is to protect the financial stability of the single employer insurance program from "potentially devasting losses which are actually encouraged under present law." Under current law, solvent plan sponsors whose businesses continue to operate may terminate their insufficient pension plans and have their liability limited to thirty percent of net worth, with the responsibility for payment of the remaining portion of the nonforfeitable benefits of the plan shifting to PBGC.

To our knowledge, AlloyTek is the only going concern ever to terminate an insured pension plan and have its liability limited to something less than the plan asset insufficiency. One other company, Facet Enterprises, is presently suing PBGC over PBGC's authority to refuse to recognize such a termination.

If every company whose unfunded vested pension liabilities exceeded thirty percent of its net worth were to terminate its plan simultaneously, obviously the aggregate costs thrust upon the single employer program would be considerable. Mr. Erlenborn has stated that such exposure is in excess of $6 billion, although PBGC's own estimate, after recovery of the thirty percent-of-net-worth employer liability, is only $4.1 billion.

We think that measuring the potential exposure of PBGC in this manner is analogous to assuming that all of the homes insured by a casualty insurance company burn down simultaneously and ignores a number of real obstacles which must be surmounted by plan sponsors who wish to terminate insufficient plans. First, the vast majority of the unfunded liabilities which comprise this exposure arise under collectively bargained plans. Measuring exposure in this manner requires the assumption that the sponsoring employer will obtain union cooperation or, at the least, acquiescence, in the termination of each collectively bargained plan. In AlloyTek's experience, the negotiations necessary to obtain union consent to plan termination are formidable. Second, an employer who terminates an insufficient plan presently can suffer the immediate expense and cash flow implications of parting with thirty percent of its net worth. This is a very stiff price to pay.

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One solution which is hinted at by Title VI, with which we strongly agree, is a significant tightening of minimum funding standards. One reason our company found termination necessary is that our predecessor employer -- who had initiated our plan and adopted its funding policy -- had adopted unrealistic funding policies in order to minimize pension cost.

To be specific, pre-ERISA liabilities were being amortized over 40 years. That is, of course, perfectly legal. But the average age of our employees was then 44. When one is 44, a period of 40 years is not only 29 years longer than the remaining period to normal retirement age, but also 11 years longer than one's life expectancy.

That means, in other words, that a significant portion of our employees' pension benefits would still be unamortized even after most of the plan participants were deceased.

Unfunded liabilities should be amortized, in our view, over a period not longer than the remaining weighted worklife of the plan participants. This insures that each participant's benefit will "be there" when he retires.

Although we agree that some change may be appropriate, Title VI of S.1541 does little to reduce the attractiveness of voluntary plan termination for those truly strapped companies for whom such action might be desirable under current law. What the bill does is to force bankruptcy upon a company. Indeed, to the extent PBGC receives monies, it will do so at the expense of unsecured creditors. This will result in a curtailment of trade credit to financially weak companies and almost guarantee a bankruptcy proceeding of which the PBGC will derive little, at the possible expense of jobs.

In summmary, Title VI of S.1541 addresses what experience teaches is an illusory problem, at possibly grave cost to companies that might otherwise avoid bankruptcy. Instead, we suggest attacking the origin of the problem with an approach to funding that matches pension costs with employee service. In so doing, one can provide lower exposure for the private pension insurance system and impose on labor and management the obligation to bargain responsibly over pension liabilities in the knowledge that such liabilities must be paid during the careers of the current workforce.

Thank you.

Senator NICKLES. Thank you, Mr. Miller.

Going to the root of the problem, saying that S. 1541 does not do it, you said that you suggested an approach to funding that matches pension costs with employee service?

Mr. MILLER. Yes, sir.

Senator NICKLES. Could you explain that a little more?

Mr. MILLER. Under present law—and there is no provision of S. 1541 which purports to change this—most pension liabilities can be amortized over a period of 30 years. An appropriate amortization period may be 30 years when the average age of your employees is 25, because most plans provide for a normal retirement age of 65.

Senator NICKLES. You are talking about moving them back to the amount of time that they have for retirement?

Mr. MILLER. Exactly.

Senator NICKLES. Your plan was terminated when?

Mr. MILLER. Our plan was terminated October 31, 1979.

Senator NICKLES. What led up to that termination, just briefly?

Mr. MILLER. We had acquired our pension plan—and indeed the business to which the pension plan related—from another company.

Senator NICKLES. You bought a business that had an existing pension plan.

Mr. MILLER. The business turned out not to be as represented and suffered some operating losses which we had not perceived and, as a result—much as Facet found it necessary to terminate its pension plans to ensure survival of the company—we also found it appropriate.

Senator NICKLES. So you terminated the plan.

How many employees do you have?

Mr. MILLER. We currently have about 300 employees. The plan has about 400 retirees. So we have more retirees than employees.

Senator NICKLES. PBGC received 30 percent of your net assets?

Mr. MILLER. PBGC has not received anything from us yet. I am not sure that they will. But they have not yet received anything.

Senator NICKLES. You are not sure that they will or you are sure that they will not? I do not understand. You are not sure that they will receive anything?

Mr. MILLER. We very recently settled litigation with PBGC relating to the termination of our plan and PBGC has not asserted against us any employer liability under section 4062 of ERISA.

Senator NICKLES. Which is 30 percent?

Mr. MILLER. Yes.

Senator NICKLES. Is your net worth zero?

Mr. MILLER. We took the position that our net worth was a negative number. It is not presently zero.

Senator NICKLES. It is not presently zero?

Mr. MILLER. No. In fact, the termination enabled the company to survive and become quite profitable thereafter. Were it not for the termination, many of our employees would be out on the street today.

Senator NICKLES. How many dollars were you talking about?

Mr. MILLER. About $4.5 million.

Senator NICKLES. They have assumed the liability for your 400 retirees plus; I am assuming vested liability with a lot of your existing employees?

Mr. MILLER. Yes.

Senator NICKLES. How many employees is PBGC actually making now for your firm?

Mr. MILLER. About 400.

Senator NICKLES. Are all of those 400 retired?

Mr. MILLER. Yes, sir.

Senator NICKLES. What about the employee that had a vested amount, worked 20 years, is still working and 55 years old?

Mr. MILLER. When those employees retire normally in accordance with the provisions of the terminated plan, they will be put into pay status by PBGC.

Senator NICKLES. PBGC has liabilities for those also?

Mr. MILLER. Yes.

Senator NICKLES. Calculating the unfunded liabilities, you are about $4.5 million, that is the cost that PBGC is trying to take care of. Now you and PBGC are in court trying to decide what amount of your firm, the 30 percent of your net worth, would be to subtract from that $4.5 million?

Mr. MILLER. We are not presently in court. They have not asserted any claim against us for employer liability.

Senator NICKLES. They have not asserted any claim whatsoever? I assume from your representation that your net worth was a negative figure so they bought that?

Mr. MILLER. I do not know what they bought. But we had a lawsuit very similar to Facet's lawsuit over our right to terminate the plan and continue in existence after the termination. That litigation was settled only a few weeks ago and it would have made sense for PBGC to assert an employer liability claim against us prior to the settlement of that litigation. It has not yet asserted a claim against us.

Senator NICKLES. Do you expect that to come about? Do you expect them to do that?

Mr. MILLER. I do not know. Our experience with PBGC is a lot like Facet's. They are not terribly predictable people. They have not been very friendly toward us, as you might imagine. So I would hate to venture a guess as to what course of action they might pursue.

Senator NICKLES. You have 300 employees working with you now. Have you started a new pension plan?

Mr. MILLER. Well, we tried to. We originally initiated a defined contribution plan for the benefit of the employees who were formerly participants in the terminated pension plan. PBGC did not like that and, in order to settle our litigation with PBGC, we agreed that, in lieu of that, we would make cash payment to our employees and then we would help them go start individual retirement accounts. So, economically, our employees are in exactly the same position that they would have been had we carried through with the plan. Economically the company is in the same position and PBGC is in the same position, but we had to go through hoops to convince our collective bargaining unit that it would be appropriate to go along with these changes.

Senator NICKLES. Do you have a collective bargaining plan and with who?

Mr. MILLER. We have the United Auto Workers Union.

Senator NICKLES. What is your average rate?

Mr. MILLER. About $9.

Senator NICKLES. How much?

Mr. MILLER. $9.

Senator NICKLES. What is your total annual payroll? I am just wondering.

Mr. MILLER. Presently?

Senator NICKLES. For the people that are covered under this. Did that include your salaried people or is this just an hourly plan?

Mr. MILLER. This is just an hourly plan. We also have plans covering other employees, those are all substantially fully funded.

Senator NICKLES. So your salaried people are all fully funded?

Mr. MILLER. Yes, sir.

Senator NICKLES. The hourly people who were going belly up, what was the annual cost to the plan before you terminated it and what was your payroll?

Mr. MILLER. The annual cost is sort of an illusive number.

Senator NICKLES. What was your minimum funding?

Mr. MILLER. That is the right question, at least the right first question. The answer to that is, about $450,000.

Senator NICKLES. So your actuary said you had to put in $450,000?

Mr. MILLER. That was the minimum requirement. Had the plan been properly funded, it would have been funded over some period shorter than 40 years and probably would have had annual contributions more like $800,000.

Senator NICKLES. Again your total payroll for that group of people?

Mr. MILLER. About $5 million.

Senator NICKLES. You purchased this company from a different group. When did that happen?

Mr. MILLER. January 31, 1977.

Senator NICKLES. So you bought this firm in January of 1977?

Mr. MILLER. Yes, sir.

Senator NICKLES. Were you aware that it had a lot of retired people with pension liabilities?

Mr. MILLER. Yes, we were.

Senator NICKLES. Do you feel like the Federal Government or PBGC or, to be exactly correct, the balance of all the employers in the United States should be making your pension payments for your company?

Mr. MILLER. I would like to think that when ERISA was enacted, Congress had something of a rehabilitative intent and figured that it was bad enough that pension plans had to be terminated, it should not also be necessary that concomitantly all the employees covered by that plan become unemployed. So we think that everyone is better off having our employees continue to have jobs and having PBGC pay the cost of benefits of our retirees rather than having PBGC pay those costs anyway and have our company go out of business.

Senator NICKLES. If you did not buy the firm, would it have gone out of business?

Mr. MILLER. Probably it would have gone out of business eventually. Liquidation had been considered by the predecessor owner.

Senator NICKLES. What are your annual sales?

Mr. MILLER. Presently about $20 million.

Senator NICKLES. Are you making a profit now?

Mr. MILLER. Yes.

Senator NICKLES. Do you mind saying what that is?

Mr. MILLER. This year probably we will make around $600,000 pretax.

Senator NICKLES. And that is after your pension contributions?

Mr. MILLER. We are not making any pension contributions.

Senator NICKLES. But your supplemental to ERISA or whatever you want to call it?

Mr. MILLER. Yes, sir.

Senator NICKLES. What kind of supplemental payments are you making now to your pension plan if you added up all those increases that you are giving so that people can set up ERISA?

Mr. MILLER. The dollar amount is about $16,000 a month.

Senator NICKLES. $16,000 a month?

Mr. MILLER. Yes, about $200,000 a year.

Senator NICKLES. About half of what your minimum funding requirements would have been if you had not terminated the plan?

Mr. MILLER. Yes, sir.

Senator NICKLES. Do you have any remorse or do you feel that maybe the law was created to bail you out?

Mr. MILLER. It would be easy for me to come in here, and many people have suggested that I should, with my head hung low, feeling ashamed of myself for having dumped these liabilities onto the Government. But I feel that Congress considered in its original enactment of ERISA whether the penalty for terminating a plan should be zero or 30 percent or 50 percent or 100 percent of net worth. It really is not inappropriate that under the law the way it is written that someone who is willing to part with the stiff penalty of paying 30 percent of his net worth should be able to terminate a plan.

Senator NICKLES. I think you made an excellent case for our justification of some of the changes that we are trying to make to go to 100 percent of net worth of general creditor status.

Mr. MILLER. I think there is some justification for some of the provisions contained in——

Senator NICKLES. Right now you bought a firm, I do not know what you paid, I do not care, but you bought a firm and then, 2 years later, you said whoops.

How much did you pay for the firm, do you mind my asking?

Mr. MILLER. We paid about $4.5 million.

Senator NICKLES. Not the same amount that PBGC just picked up?

Mr. MILLER. If you include the amount of the liabilities that PBGC assumed in our purchase price, we would have been paid about $7 million, which is a pretty stiff price to pay for a business that makes $600,000 pretax.

Senator NICKLES. You mentioned earlier in your testimony that 30 percent was a pretty tough price but you did not pay anything.

Mr. MILLER. I did not say we would not pay anything. I am not sure whether we will or not.

But all I said is that PBGC has not presently asserted any claim against us.

Senator NICKLES. I cannot think of a better reason for passing S. 1541 than your testimony that you have given us today.

Mr. MILLER. Well, I could tell you that is not my view, and if I agreed with you, I would not be here giving this testimony. I am here because I oppose the legislation and I know you favor it.

My view is that ERISA is not bankruptcy legislation. It is labor legislation, and I have 300 people on my payroll today who are working and earning a living and paying incomes taxes and paying social security taxes and supporting their families who would not be supporting their families and not be productive members of the economy had we not terminated our pension plan.

Senator NICKLES. Is the purpose of ERISA to guarantee jobs for all people or to guarantee pensions?

Mr. MILLER. I think the purpose of ERISA is to guarantee pension benefits.

Senator NICKLES. The only justification that I have heard you make is that we are trying to make some jobs. I think you are trying to make some loopholes, and that you got $4 million, and for the Government to take up a liability that you should be liable for and not all the contributing employers across the country. I am astounded that, yes, you found the law, the law as written, you were able to take advantage of it as the law is. We are trying to change that so we will not have a multitude of people that say, yes, I have a net worth of minus net worth, zero net worth, regardless of the fact that my sales are $20 million a year, regardless of the fact that I make $600,000 a year after tax, but yet we want the Federal Government to pick up all of our liabilities. Your pretax would have been well enough to continue payment to provide adequate pensions for your people as contract without changes. But, no, you made a change and then you went back and said, well, the Federal Government, you pick this up, we want to keep more of our profits and invest them some place else.

Mr. MILLER. I appreciate your viewpoint.

Senator NICKLES. I wonder if you do or not.

Mr. MILLER. I appreciate your viewpoint. I disagree with it. I think that in our case this termination was necessary to preserve employment in our company. Today we have a healthy company that was, at the time of the termination, not a healthy company. And I also think that although there are all of those floodgate arguments or slippery slope arguments that are made about it, we have done it, Facet does it, and possibly some other company does it; that there is going to be a rash of terminations—there is absolutely no evidence to support that kind of conclusion. There is no reason to believe that there will be a rash of terminations.

Senator NICKLES. I would hope that these would not. I would hope that the majority of people who are managing these funds and also working with their employers would have business ethics to the extent that they would not come to PBGC and make these claims.

Mr. MILLER. Are you suggesting that it is unethical?

Senator NICKLES. To take advantage of the law, to be able to put this type of liability on the balance of other employers, I think it is somewhat unethical. Even if it is legal, yet, I would say it is somewhat unethical.

I have no further questions. If you have another comment—I am not trying to be punitive toward you. I wanted to receive some input from your case. As you mentioned, your case has been somewhat unique. I hope it remains somewhat unique.

Mr. MILLER. So does PBGC.

Senator NICKLES. Thank you very much.

Mr. MILLER. Thank you.

Senator NICKLES. Now, our next guest is Russell Williams, president of the Agricultural Producers, representing the Citrus-Avocado Pension Trust.

STATEMENT OF RUSSELL L. WILLIAMS, PRESIDENT, AGRICULTURAL PRODUCERS, LOS ANGELES, CALIF., ON BEHALF OF CITRUS-AVOCADO PENSION TRUST, ACCOMPANIED BY JANET CLARK, MANAGER; MAURICE SIMMONS, ACTUARY; AND LEON GORDON ESQ., COUNSEL

Mr. WILLIAMS. Good afternoon, Mr. Chairman.

I have with me this morning to my immediate left Ms. Janet Clark, who is the manager of the Citrus-Avocado Pension Trust. To her immediate left, Maurice Simmons, the actuary of the trust; and to my immediate right, Leon Gordon who is counsel to the trust.

Agricultural Producers in 1974 sponsored the pension plan for the citrus-avocado industry, which you referred to and which is more commonly referred to as the Citrus-Avocado Pension Trust [CAPT].

This plan was designed to provide pension benefits for all of the hourly rated employees of these industries. It was put into effect in 1974. The plan was first approved by the Internal Revenue Service prior to the promulgation of regulations under Employee Retirement Income Security Act, ERISA, of 1974, and it was approved with an ERISA disclaimer. It has since been amended to comply with the requirements of ERISA.

Under the plan are approximately 60 employers covering about 14,500 employee participants.

As of September 1, 1981, the trust fund approximated $10,200,000. The plan has been paying pension benefits since August 1, 1978, when the first retiree drew benefits. As of this time, it is paying pension benefits to approximately 250 retirees.

Mr. Chairman, you have made the point that our written testimony will be entered into the record. We do have some comments on the other titles but we will restrict our testimony to title VI, specifically starting with section 6118. Withdrawal liability to multiple employer plans, which causes us considerable concern. As you have heard this morning, and as we have found, our experience has taught us that from time to time the employers within our multiple employer plan will withdraw from the plan. The business decisions which give rise to this action are many and varied. On occasion, financial considerations force an employer to discontinue a pension plan. Unionization may require that an employer join a union multiemployer plan.

Senator Nickles. What section?

Mr. Williams. Section 6118.

In any event, the circumstances which bring about such withdrawal are beyond the control of the multiple employer plan.

Section 6118(e)(2)(A) provides that if an insurable event occurs with respect to a single employer plan to which benefits are transferred, the multiple employer plan shall be secondarily liable to the corporation. We submit that the multiple employer plan, after having made a transfer, should not have any continuing liability for any such insurable event. The multiple employer plan was in no way responsible for the decision to withdraw, nor was it in any way responsible for the insurable event.

Section 6118(e)(2)(B) spells out the amount of the liability of the multiple employer plan. It is our opinion that the multiple employer plan should have no liability whatsoever to the Pension Benefit Guarantee Corporation beyond the amount actually received from the withdrawing employer.

Based on our experience, we submit that the statutory scheme should provide that the liability of a multiple-employer plan, upon the withdrawal of an employer, should be as follows: When an employer withdraws from a multiple employer plan, the plan's liability should be limited to the transfer or distribution of all accrued benefits attributable to service with the withdrawing employer up to the date of the withdrawal or, in the case of a distribution, the amount of vested benefits to the extent that they are or can be funded. However, such liability should be limited to the actual amount which the multiple employer plan has been able to collect from the withdrawing employer. We are thinking of a bankruptcy in this situation——

Senator Nickles. If you want to—go ahead. I did not follow everything you said.

Mr. Williams. I understand.

Senator Nickles. I was trying to think this through.

Mr. Williams. We have the same problem, that is why I brought the experts.

If an employer withdraws from a multiple-employer plan for any reason and does not request a transfer of assets to another plan, then the multiple-employer plan should distribute to the employees of the withdrawing employer all vested benefits which are funded.

The transfer or distribution should be made on or after the expiration of a full plan year after the plan year in which the withdrawal took place. This would give the plan a full plan year in which to determine the amounts to be transferred or distributed, and to determine whether any of the withdrawing employer's employees will remain in the plan. We have a portability issue here. It is our opinion that there should be no obligation to make any transfer or distribution with respect to any employee who will remain in the multiple-employer plan. Our plan provides for portability and an employee of a withdrawing employer may take employment with another employer under the multiple-employer plan and continue to accrue benefits under the plan. Therefore, there should be no transfer or distribution with respect to his accrued benefits.

We likewise suggest that there should be no transfer until after there has been a determination and notice given to the multiple-employer plan that the plan to which the transfer is to be made is a qualified plan and that the transfer satisfies the provisions of section 208 of ERISA and section 414(1) of the Internal Revenue Code of 1954.

Senator NICKLES. Can I interrupt you? Possibly maybe Mr. Simmons or Ms. Clark could explain to me.

Mr. WILLIAMS. What I am saying?

Let me see if I can summarize it quickly.

What we are basically saying quickly, is: If an employee withdraws from the multiple-employer program, that once he has withdrawn and the money is transferred, that should be the end of the multiple-employer program's liability period. If there is not a request by the employer to make a transfer, then if the employee seeks employment with another employer in the program, there should be no distribution of assets or benefits. If he does not, there should be a distribution, that is really the essence of what we are saying.

The rest is basically detail and argument.

Senator NICKLES. I think I am with you.

In other words, if he is going to work with another employer in that pool or plan, there would not necessarily be a transfer of assets from one employer to that employee and then back to that employee back. You would have resolving, the employers participating in the plan?

Mr. WILLIAMS. Yes; that is to individual employees. Once we make a transfer to a—let us, for example, say an employer withdraws from our program and goes into a single-employer program of his own, once we have gone through the transfer, made the transfer, we believe that should be the end of our liability. Should thereafter the single-employer plan go through an insurable event, the PBGC should not be able to come back against the multiple-employer plan as secondarily liable.

Senator NICKLES. OK. Let us discuss that just a moment.

If you have an employer that is participating in the multiple plan with several employers contributing in the same plan, having the same benefit, and you have an employer withdraw—an avocado producer in southern California withdraws and sets up—I am assuming it is a defined benefit plan.

Mr. WILLIAMS. Yes.

Senator NICKLES. He has an employee that has worked there for *x* number of years and he is entitled, yes, we told him you are going to receive 40 percent of your average annual service. The employee has 20 years of service and he happens to be 45 years old, he has a vested benefit from that, so you transfer his benefits. What if you do not transfer to him that vested portion of his benefit? In other words, if you transfer only a portion, let us say there is a great deal of unfunded liability from that plan transferred to him, you are saying the plan group should not be liable?

Mr. **Williams**. You heard—I will let the experts respond to that. But just as an aside, you heard the flip side of that a minute ago. Somebody buys something, they should understand what they are getting themselves into. I think we have an obligation to let them know what they are getting themselves into. But once they know what the liability is, once you buy a business, you should know what the liability is. If you do not want to take that potential liability on, you should avoid it. You should not expect someone else bail you out.

Mr. **Simmons**. The proposed legislation seems to apply that a withdrawing employer, who has a liability for unfunded vested benefits, pays that liability either to that plan or funds that liability under his new plan. That is what—well, the legislation is not that clear. There is some confusion within the legislation as to exactly what was intended and exactly how it is going to work.

Our problem is we read it and said, well, what is this supposed to mean? What it implies is that a withdrawing employer has the liability for that unfunded liability and he has to fund it.

Senator **Nickles**. The employer?

Mr. **Simmons**. Yes.

Senator **Nickles**. Not the plan?

Mr. **Simmons**. Not the plan. That has to be made clear in the legislation as to whether that is true or not.

Senator **Nickles**. And you are saying that no liability, once the separation was made, would go back to the original plan?

Mr. **Simmons**. I think it would be very unfair on the other employers if they did, because the multiple employer plan is not responsible for that particular employer deciding either to set up his own plan or going to another multiple employer plan or have no plan at all.

Senator **Nickles**. Let us take your particular trust that you have set up.

How many employers do you have participating?

Mr. **Simmons**. About 60, 65.

Senator **Nickles**. Most of them with a small number of employees?

Mr. **Simmons**. There is from 20 employees to 400 or 500.

Senator **Nickles**. You did assume a large unfunded past service, if I remember your service, 20 years of past service?

Mr. **Simmons**. Yes, it is a flat dollar amount; $4 times years of past service for maximum of 20 years.

Senator **Nickles**. You have this large unfunded liability at the outset?

Mr. **Simmons**. That is correct.

Senator **Nickles**. And this was formed by all these employers initially?

Mr. **Simmons**. That is correct.

Senator **Nickles**. Or do you have people coming in and going out?

Mr. SIMMONS. We have had people come in and people go out.

Senator NICKLES. I am thinking of a person who initially agreed to that liability, or if a person was coming in would have to be aware of that liability before he would be getting into that plan. Therefore, if he left and took his employees, he would also be taking that proportion of liability with him. But you are saying that the liability line would be drawn. He would have no recourse back to the plan?

Mr. SIMMONS. That is correct.

Senator NICKLES. Well, at least now I understand what you are saying.

Now, to incorporate that into legislation is easier said than done, but it is something that we will take a close look at.

Thank you very much. I have no other questions but we will be in touch with you and your counsel and actuary, too, if they will leave their names and numbers so we might have some additional followup questions for you.

Thank you very much.

[The prepared statement of Mr. Williams follows:]

STATEMENT OF

RUSSELL L. WILLIAMS, PRESIDENT

AGRICULTURAL PRODUCERS

BEFORE THE

SENATE SUBCOMMITTEE ON LABOR

Washington, D.C.

November 12, 1981

STATEMENT OF
RUSSELL L. WILLIAMS, PRESIDENT
AGRICULTURAL PRODUCERS
BEFORE THE
SENATE SUBCOMMITTEE ON LABOR
Washington, D.C.
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INTRODUCTION

Mr. Chairman, my name is Russell L. Williams, I am President of Agricultural Producers of Los Angeles, California.

Agricultural Producers is a trade association for the citrus and avocado industries in the States of California and Arizona. Its membership, which encompasses about 80% of the two industries, is made up of growers, harvesting associations and other harvesting entities as well as packing and processing operators and shippers of citrus and avocados.

Agricultural Producers is the sponsor of the Pension Plan for the Citrus and Avocado Industries, otherwise referred to as the "Citrus-Avocado Pension Trust" ("CAPT"). This plan was designed to provide pension benefits for all of the hourly-rated employees of these industries. It was put into effect in 1974. The Plan was first approved by the Internal Revenue Service prior to the promulgation of regulations under Employee Retirement Income Security Act (ERISA) of 1974 , and it was approved with an ERISA disclaimer. It has since been amended to comply with the requirements of ERISA.

Since going into effect the plan has added benefit schedules and an additional plan designed to cover salaried employees. The plan is unique in that it gives credit for up to 20 years of past service to an employer in the industry.

CAPT is administered as a trust by a board of five trustees who have been chosen to represent various segments of the industry. Each of the trustees is a person of wide business experience within the industry. The Trustees meet regularly and determine all policy matters of the trust. The pension plan is managed by Janet B. Clark. As of September, 1981, the trust fund approximated $10,200,000, and the investment experience of the trust has far exceeded the actuarial assumptions upon which premium rates were determined. CAPT is a model for administrative efficiency. Within approximately one year it will be completely computerized.

The plan began paying pension benefits to the first retiree on August 1, 1978. As of this time, it is paying pension benefits to approximately 250 retirees. Under the plan are approximately 60 employers covering about 14,500 employee participants. A brief description of the plan follows:

It is an employer paid plan with portability between participating employers and Past Credit awards of up to 20 years for service with the employer with whom the employee first enters the plan.

Employees become 50% vested after 5 years participation in which they work at least 500 hours per year. For each added year of service, they earn an additional 5% vesting credit. 100% vesting occurs after 15 years of service or for an active participant who reaches normal retirement age, once 5 years of service has been completed.

A Break in Service occurs in any calendar year in which an employee does not work at least 500 hours. After more than two consecutive breaks in service, an employee will lose the non-vested credits that have been accrued.

An employee with at least 5 years of service will be eligible for early retirement benefits at age 55. Benefits would be reduced by 6 1/2% for each of the first 5 years by which Early Retirement preceeded Normal Retirement and 4 1/2% for the next two years.

For an employee who is eligible for early retirement, there is an automatic pre-retirement death benefit should he die prior to retirement.

The normal form of retirement is a 50% Joint and Survivor Annuity for those employees who have been married at least 12 months at the time they retire. They may also elect to have benefit paid on a Life Only basis as an option.

Benefits are calculated in accordance with three different benefit schedules. The Past Service Benefit is multiplied times the number of years of past credit and added to the Future Service Benefit. Future Service is based on a percentage of earnings with integration with Social Security. There is a minimum benefit based upon the number of hours worked in a calendar year.

Analysis of S. 1541

It is with this background of experience that the Retirement Income Incentives and Administrative Simplification Act, S. 1541, has been studied and analyzed, and as a result of this study and analysis attention has been focused on certain problem areas covered by the proposed legislation.

Section 4307 deals with breaks in service at seasonal establishments. There is a possible ambiguity in the language of Section 4307(O)(2)(B) which sets forth part of the definition of seasonal establishment. Throughout the citrus and avocado industries and throughout all agriculture, various crops and commodities are packed, processed or handled in packinghouses or processing plants. These establishments operate on a seasonal basis according to the availability of the crop or commodity which they pack, process or handle. The definition of seasonal establishment should make it clear that it is not the seasonal nature of the crop which makes it a seasonal establishment but rather it is the climatic conditions acting directly and physically on the establishment. Therefore, in order to avoid any possible ambiguity, we should propose the following language in lieu of Section 4307(O)(2)(B):

> (B) which is a geographical location at which employment is limited by regular and recurring climatic conditions directly and physically affecting the establishment, as distinguished from any crop or commodity packed, processed or handled by that establishment, and preventing that establishment from engaging in its normal functions; and

Section 6118, Withdrawal Liability to Multiple Employer Plans, causes us considerable concern. Our experience has taught us that from time to time the Employers within our Multiple Employer Plan will withdraw from the Plan. The business decisions which give rise to this action are many and varied. On occasion, financial considerations force an Employer to discontinue a Pension plan. Unionization may require that an Employer join a union Multi-Employer Plan. In any event, the circumstances which bring about such withdrawal are beyond the control of the Multiple Employer Plan. This fact should be taken into account in determining the obligation of the Plan to make distributions, transfers to another plan, or to assume any continuing liability to the PBGC.

Section 6118(e)(2)(A) provides that if an insurable event occurs with respect to a Single Employer Plan to which benefits are transferred, the Multiple Employer Plan shall be secondarily liable to the corporation. We submit that the Multiple Employer Plan, after having made a transfer, should not have any continuing liability for any such insurable event. The Multiple Employer Plan was in no way responsible for the decision to withdraw, nor was it in any way responsible for the insurable event. It is difficult then to understand why it should in any such case have any secondary liability to the corporation.

Section 6118(e)(2)(B) spells out the amount of the liability of the Multiple Employer Plan. It is our opinion that the Multiple Employer Plan should have no liability whatsoever to the corporation beyond the amount actually received from the withdrawing Employer.

Based on our experience, we submit that the statutory scheme should provide that the liability of a Multiple Employer

Plan, upon the withdrawal of an Employer, should be as follows: When an Employer withdraws from a Multiple Employer Plan, the plan's liability should be limited to the transfer or distribution of all accrued benefits attributable to service with the withdrawing Employer up to the date of the Withdrawal, or in the case of a distribution the amount of vested benefits to the extent that they are or can be funded. However, such liability should be limited to the actual amount which the Multiple Employer Plan has been able to collect from the withdrawing Employer. The Multiple Employer Plan should be obligated to make a transfer to a Single Employer Plan, a Multiple Employer Plan, or to a Multi-Employer Plan, but that such a transfer should be made only at the request of the withdrawing Employer.

If an employer withdraws from a Multiple-Employer Plan for any reason and does not request a transfer of assets to another plan, then the Multiple-Employer Plan shall distribute to the employees of the withdrawing employer all vested benefits which are funded.

The transfer or distribution, should be made on or after the expiration of a full plan year after the plan year in which the withdrawal took place. This would give the plan a full plan year in which to determine the amounts to be transferred or distributed, and to determine whether any of the withdrawing employer's employees will remain in the plan.

There should be no obligation to make any transfer or distribution with respect to any Employee who will remain in the Multiple Employer Plan. CAPT provides for portability and an Employee of a withdrawing Employer may take employment with another Employer under the Multiple Employer Plan and continue to accrue benefits under the Plan. Therefore, there should be no transfer or distribution with respect to his accrued benefits.

There should be no transfer until after there has been a determination and notice given to the Multiple Employer Plan that the plan to which the transfer is to be made is a qualified plan and that the transfer satisfies the provisions of Section 208 of ERISA and Section 414(l) of the Internal Revenue Code of 1954. It should be the responsibility of the withdrawing employer to secure this determination from the IRS.

There should be no liability on the part of the Multiple Employer Plan to transfer or distribute assets attributable to unvested benefits because of the fact that the amount of such unvested benefits would be relatively small. CAPT for example provides for 50% vesting after five years and such unvested benefits would be for a period less than five years. It is estimated that the administrative cost of determining and transferring or distributing such benefits may exceed their value.

Having made a trans[illegible] or distribution as provided above, the Multiple Employer Plan should have not further or continuing liability under any circumstances.

In order to accomplish these changes in the proposed bill, we would suggest this language:

> (a)(1) If a contributing sponsor (hereinafter Employer) withdraws from a Multiple Employer Plan (hereinafter the Plan), then the Employer is liable to the Plan for the amount described in sub-paragraph (2)(A) and (B) and shall make withdrawal liability payments to the Plan as hereinafter provided.
>
> (2) The amount of withdrawal liability shall be the sum of:
>
>> (A) The plan's unfunded vested benefits which are directly attributable to the service of the Employer's Employees determined as of the end of the plan year in which the employer withdraws and
>>
>> (B) A share of any unfunded vested benefits which are not attributable to any Employer in the Plan and bearing the same proportion of all unattributable unfunded vested benefits as the contributing Employer's unfunded vested benefits bears to all attributable unfunded vested benefits of the Plan.
>
> (b) In any case in which an Employer withdraws from a Multiple Employer Plan, the Plan in accordance with this section shall:

(1) determine the amount of the withdrawal liability,

(2) notify the Employer in question of the amount of the withdrawal liability, and

(3) collect the amount of the withdrawal liability.

(c)(1) In any case in which an Employer withdraws from a Multiple Employer Plan, the Plan shall upon the request of the withdrawing Employer transfer assets and liabilities as hereinafter defined to a Single Employer Plan, a Multiple Employer Plan or a Multi-Employer Plan.

(2) "Assets" as used herein shall mean the share of the assets of the Multiple Employer Plan attributable to the contributions made by the withdrawing Employer less any administrative expenses of the Plan arising from the withdrawal of the Employer.

(3) "Liabilities" as used herein means all accrued benefits which are attributable to service with the withdrawing employer up to the date of the withdrawal.

(4) The Plan is obligated to make the transfer only to the extent that it has collected the sums owed from the withdrawing Employer.

(5) The transfer shall not be made before the expiration of the Plan Year after the Plan Year in which the withdrawal occured and only after there has been a determination by the IRS and a notice to the Plan that the transfer satisfies Section 208 of ERISA and Section 414(l) of the Internal Revenue Code of 1954.

(6) There shall be no transfer with respect to the service of any Employee of the withdrawing Employer who continues to accrue benefits in the Plan between the date of the withdrawal and the date of the transfer.

(d) Having made the transfer in accordance with Section (c) above, the Plan shall have no further or continuing liability with respect to the Plan to which the transfer was made or to the PBGC.

(e) If an Employer withdraws from a Multiple Employer Plan because of bankruptcy or for any other reason and does not request a transfer to another plan, then the Plan shall distribute to the Employees of the withdrawing Employer all vested benefits which are funded.

The liability imposed in the event of a withdrawal and the procedures to be followed are matters of great importance to the Plan, to the withdrawing Employer, and to the Employees covered by the Plan. In all cases, the financial integrity of the Plan and the protection of the Employees are the paramount consideration.

We thank you for giving us the opportunity to present these views to the Committee.

Senator NICKLES. Our next guest is Paul Jackson who is going to be representing the National Small Business Association.

Welcome, Mr. Jackson.

STATEMENT OF PAUL H. JACKSON, CONSULTANT TO THE NATIONAL SMALL BUSINESS ASSOCIATION, WASHINGTON, D.C., ACCOMPANIED BY CARL A. BECK, PRESIDENT, CHARLES BECK MACHINE CORP., KING OF PRUSSIA, PA.

Mr. JACKSON. Senator, I appreciate the opportunity that you have given us to state our views on this matter. Sitting here during the fairly complex proceedings this morning, I must say I also congratulate you on the close attention that you have paid. That is not customary in hearings of this sort. It is a difficult, complex area.

I am a consulting actuary appearing for NSB, and our statement has been submitted and, I will not bother reading it.

With me this morning is Carl Beck, who is president of Charles Beck Machine Corp. of King of Prussia, Pa., and a former president of NSB.

I thought the simplest way would be to ask Carl to give a few observations of his own, and then I will just try to give you our views in a nutshell, and answer questions.

[The prepared statement of Mr. Jackson follows:]

NATIONAL SMALL BUSINESS ASSOCIATION
"THE VOICE OF SMALL BUSINESS"

STATEMENT OF

PAUL H. JACKSON

ON BEHALF OF

NATIONAL SMALL BUSINESS ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON LABOR

OF THE

SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES

HOLDING HEARINGS ON S. 1541

NOVEMBER 12, 1981

> "It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small business concerns in order to preserve free competitive enterprise..."
>
> (P.L. 85-536, as amended, Section 2(a), Small Business Act.)

NSB Building • 1604 K Street, N.W., Washington, D.C. 20006 • Telephone (202) 296-7400

STATEMENT OF PAUL H. JACKSON ON BEHALF OF NATIONAL SMALL BUSINESS ASSOCIATION BEFORE THE SUBCOMMITTEE ON LABOR OF THE SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES HOLDING HEARINGS ON S. 1541

NOVEMBER 12, 1981

Mr. Chairman and Members of the Committee:

My name is Paul H. Jackson. I am a consulting actuary with The Wyatt Company and appear here today on behalf of the National Small Business Association (NSB), a multi-industry trade association representing approximately 50,000 small business firms nationwide. Accompanying me is Carl Beck, President of Chas. Beck Machine Corp. of King of Prussia, Pennsylvania, and a former President of NSB.

The Retirement Income Incentives and Administrative Simplification Act of 1981 is an important piece of proposed legislation. It is not easy reading for the average small businessman, consisting of 293 pages of law. Even the table of contents takes up six pages. While there are many, many good things in the Bill, the hearings today relate only to Title VI of that Bill, which commences at page 222. This portion of the Bill would amend certain provisions in the plan termination insurance section of ERISA, which has proven to be one of the least satisfactory in operation over the years since the enactment of the 1974 Bill.

The problems created by plan termination insurance are indeed complex. The solutions to these problems, however, are even more complex. While we believe that the sponsors of this legislation have incorporated the latest thinking of certain groups as to what might solve these problems and have certainly contributed to the dialogue by including those solutions in S.1541, the National Small Business Association has concluded, after the most careful study, that the cure suggested is far worse than the problems that would exist if we simply went on into the future without any change in the present law. Thus we recommend that the sponsors of this Bill delete Title VI and in its place establish a Commission to study the plan termination insurance problem, to hold public hearings and to accept the views of all parties affected by this matter, including big business and small business, labor and public interest groups, plan administrators and academics, credit experts and accountants, and others. Although the program is called "insurance", technical advice should be sought not only from insurance companies but also from those who provide technical services to non-insured retirement programs. Only by receiving the views from a complete cross-section of those affected can a properly balanced solution be devised.

Termination Insurance

Before the enactment of ERISA, it was customary for the sponsors of single-employer pension plans to limit corporate liability to the amount actually put into the pension fund. ERISA extended to plan participants (as a gift from Congress) a guarantee that they would receive no less than their guaranteed benefits, either from the pension fund, or, as a matter of last resort, from the Pension Benefit Guaranty Corporation. While employers were to pay $1.00 per year per plan participant for this "termination insurance" and were suddenly forced into the position of being a guarantor of benefits they had formerly merely been funding for, the PBGC's claim on their assets was to be limited to 30% of their net worth and even as to that limited liability, the PBGC was instructed in Section 4023 of ERISA to insure any employer against the contingent liability thus created. In this way, under ERISA employers would have a fixed and modest insurance cost each year which, in addition to their annual pension contribution, would completely absolve them from a far more massive liability for the program. The PBGC never developed this insurance and indeed this provision of ERISA was deleted with the passage of the Multi-Employer Pension Plan Amendments Act of 1980.

The Multi-Employer "Solution"

In February, 1980, at hearings on the Multi-Employer Pension Plan Amendments Act, the National Small Business Association was one of the few groups testifying strongly against the details of the program. At that time, our statement seemed extreme to some. We said, for example, "H.R. 3904 truly makes participation in a multi-employer plan the financial equivalent of tiger riding. There is clearly only one alternative for small business, namely to stay out of all multi-employer plans even if they are well run. A small business is far better off agreeing to a cents-per-hour or dollars-per-week figure with the employees and putting that amount into their paycheck or into an IRA for them." We noted further that "the net result of H.R. 3904 is that it imposes a substantial burden on employers who have been in multi-employer plans that extend into periods when they are not participating in those plans. The intent of ERISA and contingent employer liability insurance was to require employers participating in these plans to pay enough while they were participating so that the benefits under the plan could actually be paid to the people." Finally, in our summary, we noted that "It is unfair to small business to develop a complex maze of legal verbiage which has the effect of entrapment of the small businessman in a plan in which he may bankrupt himself if he leaves." Nothing that we have seen since the enactment of the Multi-Employer Act has led us to moderate our position in any way. Indeed, if anything the actual results of that Bill are far worse than we imagined.

What Would be Changed for Single-Employer Plans?

The groups that have been busily drafting amendments to the single-employer plan termination section of ERISA have patterned their approach on the same basic set of principles that was used for the multi-employer legislation. The approach consists of (1) increasing the benefits to the covered participants to the value of full vested benefits while the sponsoring employer is solvent, (2) increasing the guaranteed benefits for participants by deferring the date of application of the 20% phase-in for guaranteed benefits, (3) making the employer liable for the value of vested benefits (rather than phased-in guaranteed benefits) until he goes bankrupt, (4) reducing the amount the PBGC might have to pay by making them a general creditor, and (5) giving the PBGC the right in the case of any such bankruptcy to go back for a period of as much as 15 or 20 years to any employer who sold part of a business and transferred a portion of a pension liability to a buyer which eventually went bankrupt.

Taken as a whole, this proposed legislation would be a bitter pill indeed for the small business community. Their present right to terminate a plan and have benefits cut back to a guaranteed level if business conditions are so bad they can't afford their pension plan would be eliminated entirely. Their present right to have their liability limited to 30% of net worth as defined by the PBGC would be eliminated entirely. Even the right of an owner of a small business sponsoring a pension plan to sell his business and take the proceeds and retire on them with some peace of mind would be eliminated by the imposition of potential contingent liability. And there is a new section imposing personal liability on the owner of a small business who restructures a significant amount of debt, sells 10% or more of his assets, makes an assignment for the benefit of his creditors, or even extends the terms of any debt, if he should fail to notify the PBGC within 10 days! These are the hazards that befall the small businessman who is generous enough to offer his employees a pension rather than a thrift or savings plan!

The Effect on the Sale of a Small Business

One of the most onerous provisions that would fall primarily upon small business is the new section that would impose liability on the seller of a business if the buyer should go bankrupt within 15 years after the date of sale, leaving the PBGC with a liability. It is believed that this section is intended to prevent situations where a large profitable business spins off a very small weakly capitalized business with a substantial pension liability which is subsequently imposed upon the PBGC. This problem, to the extent that it exists, is essentially a big business problem because of the heavy fixed costs involved in spinning off a corporation, splitting a pension plan into two portions and subsequently folding the second business down. Indeed, the one "horrible example" usually cited is the Bendix-Facet case where the spinoff was actually forced by the federal government! Unfortunately, while the problem is restricted to large organizations, the burden of the "solution" in Title VI would fall largely on small business because the calculations and recordkeeping would be required in each case where a business sponsoring a pension plan is sold, and small businesses are sold much more frequently than large ones.

A small business is typically the greatest financial investment that the owner has. When he wishes to retire he must sell his business in order to have the funds to retire on. In the event of his death the business usually has to be sold and the proceeds are frequently all that a surviving widow has for financial security. Title VI would impose upon each one of these natural transactions a potential contingent liability based on the possibility that the buyer of the new business might possibly go bankrupt. This would force every small businessman who sells his business to take on a risk which the federal government itself is not prepared to -- namely, to insure a group of workers against a possible pension loss arising from the bankruptcy of their employer. This is grossly unfair in principle. Also there are better ways to solve the perceived potential problems.

Possible Solutions

The small business community is aware of the fact that PBGC's premiums have gone from $1.00 in 1974 to $2.60 today, and that the $2.60 amount might well go to $5.00, $10.00 or $20.00. While such increases would certainly not be appreciated, it is still the plain and simple fact of business life that a recurring expense that is fairly stable in amount is far preferable to exposing the business to the haphazard and capricious imposition of $100,000 or $1,000,000 liability assessments. Small business supports the termination insurance program. We would far prefer to pay "insurance premiums" in small amounts than to run the risk that the buyer of a small business might go bankrupt and then have Congress stick the seller's widow with a huge liability because the PBGC can't handle it.

Recognizing that there are some possible problems facing PBGC, we have the following suggestions:

1. Increase the 30% limit on plan sponsor liability to 40%. What's the big hurry to rush to a 100% level?
2. Prohibit any employer who has terminated a pension plan and dumped an unfunded liability for guaranteed benefits on the PBGC from establishing any new tax-favored program or amending any existing program to increase benefits or coverage for a period up to seven years after that termination. This would impose burdens only on those employers who are playing games with the plan termination program and would not impose contingent liabilities on every employer who sells his business. The statutory language to accomplish this is contained in the attachment to this statement.
3. Modify the PBGC program so that it collects funds from the private sector only to pay benefits and not for investment purposes. At the

present time, if a plan terminates the PBGC develops a single-sum value of all guaranteed benefits to be paid by the plan, subtracts off the assets and attempts to collect the balance from the sponsoring employer. So far as going after the sponsoring employer, this may be a perfectly reasonable approach. Unfortunately, however, the concept that the PBGC needs in hand immediately all of this money carries over into the premium process. The PBGC should take advantage of the fact that the cash flow characteristics of a pension fund are extremely stable and predictable, while the single-sum value of unfunded liabilities is extremely erratic and unpredictable.

Why Pensions?

As Title VI is written, the small business that sponsors a private pension plan not only will have to comply with funding, benefit accruals, suspension of benefit, hour of service, prohibited transaction, PBGC notification, premium payment and form filing requirements, but also it will be faced with a sharp cutback in the amount of credit available, a higher cost of credit, and contingent liability upon the eventual sale of the business. By reserving the harshest of these penalties only for the sponsor of a defined benefit pension plan perhaps what Congress really has in mind is the elimination of such plans entirely. After all, what used to be called a pension plan ERISA calls a defined benefit pension plan, and what used to be called a profit sharing thrift plan, ERISA calls a defined contribution pension plan. The names are confusingly alike but the ERISA penalties land only on the sponsors of defined benefit plans, i.e., on pensions, not savings. Both types of plans can provide income after retirement. Why is it that small business would like to provide pensions rather than or in addition to savings plans? It is because pensions have the following advantages:

1. A pension plan pays reasonable benefits immediately while a savings plan takes a long time to develop satisfactory amounts.
2. A pension plan can provide reasonable benefits for early retirement or disability, while a savings plan usually pays too little.
3. A pension plan can provide reasonable benefits for individuals retiring well after normal retirement age, while a savings plan usually pays too much.

4. Stock and bond market fluctuations do not affect pensions, only their cost. Under a savings plan it is the plan participant who takes on the full market risk.

There must be something good about pensions or we wouldn't have them. On the other hand, if Congress persists in imposing penalty after penalty on those who sponsor these generous employee benefit programs, they will disappear from the scene entirely. Small business is keenly aware of the nightmarish problems Congress got them into with the Multi-Employer Bill. Only 13 months have elapsed since the enactment of the multi-employer pension law, and already there are more really serious problems arising than have arisen in the entire seven-year period since the enactment of ERISA and Title IV. It seems incredible that Congress would be considering the same kind of "improvement" based on the same unsound principles for the single-employer termination program.

What Should be Done?

If claim costs are to be held down and the PBGC is to be preserved, then (1) the guaranteed benefit levels for new plans and increases in plan benefits should be phased in over 10 years rather than 5, (2) the maximum guaranteed benefit should be frozen at its present level or the maximum Social Security benefit for the year of plan termination, whichever is greater, and (3) PBGC should be instructed to redefine basic benefits prospectively so that there is actually something left for them to call a "non-basic benefit" and insure on a voluntary basis in accordance with Section 4005 of ERISA. After all, one of the chief purposes of the Pension Benefit Guaranty Corporation is "to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants."

Summary

The National Small Business Association opposes the provisions set forth in Title VI of S.1541. We do so not because we do not see the potential problems that face the present program but because we see even greater problems arising out of the solutions proposed therein. We strongly urge Congress to delay action on this important portion of the legislation until such time as all of the complexities can be considered and thoroughly analyzed. The design of a plan termination insurance program is not one that should be undertaken in floor debate. As Jacquin's postulate states, "No man's life, liberty or property are safe when the legislature is in session." The problems should be explored in a quieter atmosphere and given the most careful consideration. Congress does have an opportunity to act responsibly by establishing a study commission to review every aspect of the problem, including the possibility that if PBGC premiums are held down by placing greater liability on sponsoring employers, those employers may be forced into bankruptcy at an earlier date or denied credit and prevented from continuing or expanding their businesses. There are simply too many important aspects of normal business operations that are affected tangentially by second-order effects of this proposed legislation for it to be considered seriously as a "solution" to the problems facing the plan termination insurance program. A far less onerous proposal that would solve the same problems is set forth in the attachment to this statement. We ask that you consider it. We appreciate the opportunity you have given us to present it and to speak out on this important matter.

Attachment to Statement of Paul H. Jackson on Behalf of National Small Business Association

Suggested Amendments to Title IV of the Employee Retirement Income Security Act of 1974

Section 4062.

(a) This section applies to any employer who maintained a single-employer plan at the time it was terminated, but does not apply -
  (1) same as present law,
  (2) same as present law, or
  (3) to an employer who continues to fund a plan either directly or through a third party, excluding the Corporation, such that benefits are paid under its terms as they fall due, irrespective of the fact that the plan is amended to provide for no new participants or accrual of benefits after a stated date.

(b) Any employer to which this section applies shall be liable to the Corporation in an amount equal to the lesser of -
  (1) the excess of -
    (A) the current value of the plan's benefits guaranteed on the date of termination over
    (B) the current value of the plan's assets allocable to such benefits on the date of termination, or
  (2) 40 percent of the net worth of the employer determined as of the date of termination, computed without taking into account any liability under this section.

(c) For purposes of subsection (b)(2) the net worth of an employer is -
  (1) the greater of (A) the employer's net worth in the latest published financial statement, or (B) the current market value of the employer's common stock multiplied by the total number of shares outstanding, and

(2) increased by the amount of any transfers of assets made by the employer determined by the Corporation to be improper under the circumstances, including any such transfers which would be inappropriate under the Bankruptcy Act if the employer were the subject of a proceeding under that Act.

(d) Same as present law.

(e) Additional Employer Restrictions and Coordination with the Internal Revenue Code and ERISA -

(1) If an employer described in this subsection (e) terminates a plan under circumstances resulting in the creation of a liability to the Corporation as described in subsection (b)(1), such employer may not establish or cause to be established any new program providing for the deferral of compensation or payment of welfare benefits, or increase coverage or benefits under any such program in existence on the date of termination, before the earlier of (i) the taxable year of the employer in which such liability is satisfied, or (ii) the seventh taxable year of the employer following the earlier of the taxable year in which the amendment, resolution, or action by the Corporation terminating the plan is adopted or made effective. For purposes of this section -

(A) An "employer" is deemed to include the entity terminating the plan and each other affiliated organization which is considered to be part of a controlled group with such entity by operation of sections 1563, 414(b), (c), or (m) of the Internal Revenue Code or any other organization which shall become affiliated with the controlled group. For purposes of this provision, an entity terminating a plan within 5 years of its creation and which was created by the spin-off or sale of assets shall be considered to be a member of an affiliated group with the entity or controlled group which created it.

(B) A "program providing for the deferral of compensation" is to have the same meaning as "employee pension benefit plan" as described in section 3(2) of Title I of ERISA except that such definition shall be limited only by the exclusions of section 4(b)(1), (2), and (3) of Title I of ERISA and no other exclusions or limitations shall be applicable.

(C) A "program providing for welfare benefits" is to have the same meaning as "employee welfare benefit plan" as described in section 3(1) of Title I of ERISA except that such definition shall be limited only by the exclusions of section 4(b)(1), (2), and (3) of Title I of ERISA and no other exclusions or limitations shall be applicable.

(2) Amounts paid by an employer to liquidate its liability to the Corporation and remove the restrictions imposed by this subsection shall be deducted in accordance with Section 404(g) of the Internal Revenue Code. Solely with respect to an employer who is affected by this provision as a result of a spin-off or sale of assets which resulted in the creation of a new employer who then terminated a plan within 5 years of the spin-off, the liability of the employer who spun off the assets shall be the value of the unfunded guaranteed benefits at the date of spin-off adjusted to reflect interest to the date the spun-off entity terminated the plan. This amount shall be substituted in subsection (d)(2)(A) for the amount which would otherwise be determined from subsection (b)(1).

(3) For provisions relating to the effects of this subsection on other laws, see -

(A) section 402(a) of Title I of ERISA relating to prohibition on establishment or amendment of plans,

(B) section 404(a) of Title I of ERISA relating to fiduciary breaches for establishment or amendment of plans,

(C) section 406(a) of Title I of ERISA relating to prohibited transactions,

(D) section 4975(a) relating to prohibited transaction excise taxes,

(E) sections 401(a), 403(a), 405(a), 408(a), 408(k), and 409(a) of the Internal Revenue Code for non-qualified status, and

(F) sections 162, 212, 219(a), and 404(a) for non-deductibility of contributions.

Section 4068.

(a) Same as present law.

(b) Same as present law.

(c)(1) Except as otherwise provided under this section, the priority of the lien imposed under subsection (a) shall be the same as the claim of any general and unsecured creditor of the employer.

(2), (3), (4) Same as present law.

(d) In the case of bankruptcy or insolvency proceedings, the lien imposed under subsection (a) shall be treated in the same manner as a tax due and owing to the United States for purposes of the Bankruptcy Act or section 3466 of the Revised Statutes.

Explanation of Suggested Amendments to Title IV of the Employee Retirement Income Security Act of 1974

The revision to section 4062 of ERISA reflects changes designed to deal with certain perceived potential problems or abuses of the present PBGC single-employer termination rules without changing the present conceptual framework for imposing liability.

The proposal retains guaranteed benefits as the measure of an employer's liability but increases the net worth limitation to 40% from the present 30%. If it were desired to prevent profitable employers from taking advantage of the PBGC coverage, then the deductibility of payments to PBGC could be eliminated entirely and the payments treated as an excise tax. Also, it takes the approach that rather than imposing contingent liabilities on sellers or drastically increasing an employer's liability, employers who terminate plans leaving a liability with the PBGC should be treated as bad credit risks in terms of being allowed to amend any other existing tax supported programs or to adopt new ones. In view of the fact that it has been actions by large employers which have created the present push for revisions of the single-employer termination rules, this is probably more effective and attacks the specific abuse situations rather than saddling every employer with a greatly increased liability.

The penalty described above is also one which would be hard for accountants to turn into a balance sheet liability affecting the saleability of an entity. Also along these lines, the PBGC lien for a termination liability has been reduced to that of a general unsecured creditor so long as the employer is solvent. Only in insolvency or bankruptcy would the PBGC have a tax lien.

A more detailed analysis of the changes and the reasons for them follows:

Section 4062(a)

This section is basically unchanged from present law. What has been done is to make it clear in the law itself that a frozen plan which an employer continues to fund is not to be considered a termination. This is the current PBGC administrative position and should present no problems with them.

Section 4062(b)

This revision simply changes the net worth limitation from 30% to 40%.

Section 4062(c)

This revision changes the definition of net worth to make it an objective determination rather than a subjective one. The fact that there is less leeway for the PBGC in determining an employer's net worth should be acceptable to them in the light of the one-third increase in the net worth limitation. The 40% limitation will lessen their need to make the net worth of the employer as great as possible in order to squeeze out the greatest payment.

Section 4062(e)

This is the new "stick" provision which prevents an employer, as broadly defined as possible, from establishing any new tax supported plan or amending an existing plan to increase benefits or coverage for seven years after a plan has been terminated under circumstances that leave an unfunded liability for guaranteed benefits with the PBGC. The term "employer" is defined broadly enough to include the organization which spins off or sells assets to create a new employer which is unable to continue its plan or simply goes under. The limits, however, in this situation are that the spun-off employer must terminate the plan within 5 years from spin-off and even in that event the creating entity's liability is limited to the unfunded liability for guaranteed benefits at the date of spin-off increased at interest.

The definition of the liability in this situation is placed in this provision rather than in (b) because it is intended to be viewed as an alternative to the non-cash penalties imposed by this section. Thus, it is not a liability but rather an optional payment to escape other non-balance sheet penalties. If paid, however, it is deductible.

The definitions of pension plan and welfare plan are extremely broadly drawn. The exclusions referred to, and the only ones permitted, are governmental plans, church plans, and state required workers' compensation and disability plans.

Subsection (3) is added to indicate the scope of the other provisions which should be amended to make this most effective. Probably the most important would be a prohibited transaction tax based either on the amount of unfunded guaranteed liability, or better still, a tax of $10 per day per participant in the prohibited programs if one is established or amended.

4068(c) and (d)

This simply changes the PBGC's claim from a tax lien to that of an unsecured general creditor in the case of ongoing employers. The 40% of limitation effectively places the PBGC claim after the satisfaction of all other general creditors since their claims must be deducted in the process of determining net worth. Thus credit ratings should not be affected. The tax lien is retained for insolvency and should be an incentive for other creditors to keep an employer going, if possible.

Mr. Beck. Thank you, Senator.

I have read the testimonies that were submitted for the hearing today. I have listened throughout the hearing, and I am impressed by the fact that it would appear that we are calling on a dozen fire companies to put out a candle.

I am aware of the fact that there is a moral to that story, and that is, do not light any candles. When you get fire insurance, that does not necessarily assure that everybody is going to go out and burn down their house.

The problem that I see, it is that PBGC is not insurance, even though a lot claim it to be. It really is a taxing agency.

Now, let us recognize it for what it is. If it is a taxing agency, I think there ought to be some clear limits as to what its taxing authority is.

When I testified, just last week, before Mr. Nowak over in the House on interest rates and availability of capital, I emphasized the point that the biggest problem today is the uncertainty, and if there is anything unfortunate in this bill, it seems to me, it is that it develops new sources of uncertainty, and this I think is the major concern to small business, that we do not know what our liabilities may be, and to our practically sole source of capital, our bank, they are going to look at these potential liabilities in the worst way, in order rightfully to protect their depositors.

Therefore, it is going to be much more difficult to get bank support, and it is going to be much more difficult to sell a business.

I was interested in the comments that one of our people made this morning, where he said the contingent liability of sellers will make it difficult for a company to structure a sale or spinoff simply in order to shift its pension responsibilities to the Pension Benefit Corp. He made a mistake. He should have put a period after sales. So the sentence should read, "Contingent liability of sellers will make it difficult for a company to structure a sale."

That is the essence, I think, of our small business concern, as well as some of the many details that Mr. Jackson is an expert on.

Senator Nickles. Just to clarify, Mr. Beck, a little bit further on the contingency part, there is an exemption for firms with 35 or fewer, as far as the contingency.

Mr. Beck. We have 36 employees.

Senator Nickles. I thought you might.

Mr. Beck. If I might just give you, since I think it is relevant, a very recent summary of what we did with our own plan some years ago.

Senator Nickles. Do you really have 36 employees?

Mr. Beck. Yes. Some years ago, we discontinued a plan that we had. We tried to annually pay a bonus of somewhere from perhaps 1 to 4 percent of payroll, depending on the economic climate. We had been paying this into a profit sharing retirement plan. When ERISA came in, after about 2 years, we discovered that although we wanted to pay approximately 1 percent (business was a little rough at the time) we wanted to pay approximately 1 percent of gross salary in a bonus that year, even though we were hardly profitable, if at all; we found that the external cost to comply with ERISA was running over 4 percent of payroll, and our internal costs, as best as we could estimate, were about 1 percent.

So, somewhere between 4 and 5 percent of gross payroll were our costs. We were paying this to comply with ERISA, and denying these benefits to our employees. So we scratched the plan.

Now, I think what we are facing with here is a similar situation, and it is great to have perfect plans, and perfect protection, and not have any plans at all, that is what it is going toward. Look what happened to ERISA in the number of plans that got canceled. A fabulous number of small business plans, and I would not wonder if you would not have a similar type of thing that the legislation has proposed today.

Senator NICKLES. I might make just a couple of comments to you.

One, do you have a machine company?

Mr. BECK. Yes, a line of industrial machinery.

Senator NICKLES. Well, I come from a machine background also, and similar size, a little larger, not much. I have had a similar type bonus program, very similar to what you are talking about.

Also, do you have the defined benefit plan now?

Mr. BECK. No, we do not.

Senator NICKLES. Because of ERISA?

Mr. BECK. That is correct.

Senator NICKLES. Have you had one in the past?

Mr. BECK. We have in the past.

Senator NICKLES. Did you cancel that?

Mr. BECK. We had insurance individually funded, and so on, and so forth, and changed over a period of time, finally we ended up with a retirement plan based on bonus distribution, and now, of course, what we do is encourage employees to put the money we give them into their own IRA's, and under the new tax law just passed, we hope we might be able to encourage that, and expedite that a little bit better, and that is a step forward, certainly.

Senator NICKLES. We are trying to move in that same direction, and we are trying to make it where a small business person can comply with the rules and regulations.

One of the comments that I heard you make, or that was made, I believe by yourself, or Mr. Jackson, is the uncertainty of the change.

Mr. BECK. I said that, yes.

Senator NICKLES. The idea that well, maybe this is too massive a piece of legislation to try to take care of a few small problems, but a couple of things, one, the law was written in 1974. It is a very complicated piece of legislation, as everyone readily admits. Everyone, I think almost without exception, has ultimately stated, when confronted with some of the abuses that have taken place, or are liable to take place, have admitted, yes, we need to make some changes.

Now, those changes could be made one of two ways. They could be done piecemeal. We could try to fix a little thing here, or here, or we could go comprehensive. There are a lot of things in the particular bill as introduced. We can throw in a lot of things to make some changes on, and this is what we are trying to do right now.

I notice that there was substantial input in the back, if I am correct, am I not, Mr. Jackson, of some suggested changes as recommended by small business?

Mr. **Jackson.** Yes.

Senator **Nickles.** We are very, very interested in those. I have not personally chewed on them with staff, to see how we could incorporate them in the overall piece of legislation. We may accept some, and we may not. But we are trying to make ERISA a better piece of legislation for all business, including small business.

We had a lot of testimony from persons on our first day of hearings, on the overall concept of the act. Today is primarily on title VI, on the insurance provisions, but on the overall concept of the act, of how punitive it has been for small business, we have somethings in here to try to make it much easier and better on small business, changing some of the reporting, and disclosure requirements, where you do not have to have people, in your case, a firm of 36 people, have somebody spending so much time on filling out the forms, and coming out with the data.

Mr. **Beck.** I have been close to that for several years.

Senator **Nickles.** This is a lot of what we are trying to do. On the title VI portion of it, yes, there is some abuse that is legal now, and actually is encouraged, and somebody can say this is a prudent decision to make. Let us dump it on PBGC, and continue operating our business.

Mr. **Beck.** The existence of PBGC encourages that. It says here is a way to get out. If it did not exist, it probably would not be the encouragement.

Senator **Nickles.** That is correct, and if I had been in Congress in 1974, I would probably have opposed its enactment.

Mr. **Beck.** And we opposed it then.

Senator **Nickles.** I appreciate that, but given that, and the political reality, what we are trying to do is make some changes to eliminate some of those abuses, to make it a little more workable. Because if you do not, you do not have the plan now, but I foresee those premiums coming up in a compounding rate.

Mr. **Beck.** But those premiums are predictable. Now, how much they are, you can pay them every year. It is an ongoing basis, and you do not have a liability sometime in the future, that maybe you have to come back and pay twice the premium that you paid 5 years ago, because they did not charge enough.

The uncertainty I am talking about is not uncertainty of change, and certainly the elimination of having to pay premiums on an insurance policy, that is not the problem. The problem is the uncertainty that 20 years from now my wife might have to shell out a couple of million dollars, or something, if I had a plan, because I sold my business now. This is the kind of uncertainty that I am talking about.

The buyer who does not know what his potential liability might be, the buyer of a business.

Senator **Nickles.** Let me ask you a couple of questions.

There are some exemptions in the bill right now that we have wrestled with, the premium exemption for firms.

Mr. **Beck.** I said I am against that. Do not exempt the small business.

Mr. **Jackson.** The National Small Business Association has reviewed that and agrees. I might add, Senator, that we did look at titles I through V. We did not ask to comment on them. We have no opinion on title I, because it is essentially an effort to reorganize the Government in a more efficient way, and we are not experts on the reorganization of so massive a group.

Titles II through V we are supportive of. We found very little that we felt was harmful. Generally, we felt it was a step in the right direction.

Our problem with title VI is that while every one of the other changes in the titles, II through V, are progressive changes, in the sense that you are taking a rational finite step to improve some minor problems, and to improve the ERISA, what you have done in title VI is actually a major step.

I agree with the testimony that Harrison Givens gave regarding lenders. I think Mr. Niskanen was incorrect. Lenders do not now view an unfunded pension liability as a threat to their debt because it isn't.

Let me give you an illustration. Chrysler has borrowed money from the Federal Government, roughly it has $1 billion in unfunded pension liabilities. Perhaps Chrysler may have $1 billion in bonds, and $2 billion in Chrysler Financial Corp. bonds, and if Chrysler went under at the present time, under the present law, let us say the creditors would get 90 cents on a dollar, to pick a number. PBGC would absorb $1 billion of loss. It would probably have to spread that over a 10-year period for collection purposes even though it would not need the money to pay benefits.

The PBGC premium would then have to rise from $2.60 to $13. That is a big increase in dollars. Under the alternative, in S. 1541, the PBGC, assuming 90 cents on the dollar is right, would end up getting $675 million, their deficit would be $325 million, and the $2.60 would have to go to $6. Either way you have an increase in premium, sharp one way, slightly smaller the other. But if you are going to look at the PBGC and the premium, and say this helps the PBGC, you ought to ask "what does it do to everybody else?"

Well, there is $675 million that the PBGC got from the other creditors. The stockholders have already lost everything. The other creditors, include insurance companies and banks, who are custodians of other peoples' money, and in effect that burden falls on savers, or the purchasers of insurance policies. It also falls on pension funds, which may own some of the Chrysler financial debt, that adds to the burden of those plan sponsors.

It also falls on profit-sharing plans, but the sponsors of profit-sharing plans have no real concern at all. There may be a fiduciary problem as to why they bought Chrysler financial paper, but that loss falls on the participants. The point is that the PBGC must not be viewed as an isolated body, when people in Congress and the White House, are looking about for ways to protect it.

Is the organization worthwhile protecting? I think it is. I believe in pensions. When I retire, I want to get one from my employer. I do not want to have them hand me a stack of common stock, and say here, Paul, I hope you make it. I could not invest them. I would probably do a bad job, and I would feel very uncomfortable.

Senator **Nickles**. Do you agree with Mr. Beck's statement? I appreciate it, because I have looked at it, it is not so much insurance as it is a tax?

Mr. Jackson. In ERISA the Pension Benefit Guaranty Corp. is providing plan termination "insurance," and because it is called "insurance," there are references to premium payers, sound insurance principles, and so on.

The PBGC is not an insurance program of the type that sound insurance principles apply to, like the Equitable life, the Metropolitan, or the casualty insurance companies.

Senator Nickles. You do think we could talk to the majors and to get them to self-insure their programs?

Mr. Beck. You have not tackled social security yet, and that is supposed to be an insurance company program, and it has not worked, either.

Mr. Jackson. The real problem is that PBGC an assessment society. What you have is an assessment that is levied on some people to pay the pension losses that were created by other people, including, I might add, the Federal Government, by enacting ERISA and guaranteeing the benefits. Some people are asked to pay for the cost of others, and no one who is paying the premium views his share of somebody else's loss as "fair." It is not a premium for insurance because PBGC does not insure anybody.

The first thing to note is—assessment societies are very delicate things, and historically they have not been very successful, because as the rates go up, people drop out. You have here a mandatory one, in which anyone who has a private pension plan, as opposed to profit sharing, thrift, has to pay the assessment. But you also have the interesting situation that people do not have to have those plans.

The last estimate that I made, based on regression analysis was that by the end of 1981, there will be something over 200,000 pension plans that do not exist now, that would now have existed if ERISA had not been passed, and about 4 million workers who would now be covered by pension plans, if ERISA had not been passed, who have nothing.

Now, the ones who still have something may have something better, but we are dealing here with a balance. As Carl says, if you keep loading trinkets on this Christmas tree, if you put a small businessman, for example, in a position where he cannot get credit he will not put in a pension plan. If you take the approach that Mr. Niskanen submitted this morning, that instead of 35 people, you exempt a half a million of unfunded liability or less, and supposing I am a businessman and I have a plan that has $1 million of liability, and I have $700,000 of it funded. I only have $300,000 unfunded, so I am safe, but when the stockmarket drops all of a sudden, I have $600,000 unfunded and now I have a liability, and at that time when I go to see my banker, he says, well, you have got $600,000 already on your books, I will not lend you money. That does not happen today under ERISA. Businessmen are not dumb people, they are intelligent. They may not be able to read the laws, but they can read the newspapers as to what happened to this group or that group.

The people are now reading about what is happening in the multiemployer area, where people have to drop out of a business, because of bad business conditions, and they get slapped with $1 million or $2 million note from the Central States' fund, or something. It is that haphazard falling of immense amounts on this group, that group, and the other group that creates problems. It is telling somebody like a Carl Beck, for example, if he had a pension plan, and if he sold his business to somebody else, that he, as an individual, should self-insure the risk that the buyer will go bankrupt because the Pension Benefit Guaranty Corp. in Washington, D.C., cannot do it.

Well, I can only say if the PBGC cannot do it, for heaven's sake, do not tell Carl that he has to do it. The end result will not be that the PBGC is going to be successful. People like Carl are not going to be able to put pension plans in, and this base that the PBGC collects its premiums on is going to erode and shrink, and you have a real "assessment society circle." As the premium goes up, more people get out; as more liability is levied, still more people get out; and the next thing you know the whole thing collapses in a pile of ashes.

I do not want to see that, and I am sure you do not.

Senator NICKLES. I do not, and I might just clarify a point; that is, a whole big thrust of what we are trying to do. So I think some of our objectives are somewhat the same.

I have caught, from your comments, some reservations as far as the creditor status, whether it should be general creditors, or subcreditor.

Mr. JACKSON. I would be willing to have general creditor status for the PBGC, providing that the claim of the PBGC was limited to some percentage of net worth which reduces the stockholders' equity. I would even buy 100 percent of net worth.

Senator NICKLES. Let us talk about that.

Mr. JACKSON. In our testimony we suggested raising the 30 percent to 40, and defining net worth in a way that is simple, so that you do not have court cases on this all the time. And this is what is happening under the multiemployer legislation. Bills for withdrawing liability go out. Money does not come into the fund, and a lawsuit goes on, and everybody is hiring lawyers.

Senator NICKLES. Multiemployer is different, and we are going to take that up at a different time.

The single employer is not all that difficult. Here again, you have made an excellent point: If changes are not made, we are going to see this premium go up. You are going to see more and more employers getting out.

I think your testimony also, I believe, alluded to the fact that you are going to see less defined benefit plans and more contribution plans. I think you are right, regardless of whether we pass this or not.

But if it is not passed, I think that you will see much more rapid, and much quicker—as this was stated by Mr. Nagle who is chairman of PBGC—rate escalation. Premium escalation can be much more rapid; for example, the termination, or getting out of the defined benefit plan is going to be much more rapid. People are going to say I am going to get out before I have to pay for everybody else. You are going to have that domino effect take place faster if we do not eliminate it, and have some recourse to one—firms that are spinning off and dumping liabilities, if we do not have some recourse, and I understand, as I am a small businessman also. But I personally think somebody is going to be buying your business or my business now. The buyers are going to be astute enough to be looking at pension plans, plus liabilities, to see where they stand.

Mr. BECK. If you cannot afford the price, so much, then you cannot afford to sell it.

Mr. JACKSON. And it makes it more difficult to find a buyer. If you have this law, any potential buyers of small businesses will suddenly look at pensions as liabilities, and take that into account.

Senator NICKLES. They should be looking at them all along. I am in the machine business, but——

Mr. JACKSON. But you do not look at the liability, Senator.

Senator NICKLES. The heck I do not.

Mr. JACKSON. I think the pension liabilities are overstated and tend to create the illusion of massive debt.

What you should look at is an ongoing pension cost, and the question is: Can the business support that under normal operating conditions?

If you take a company, like a Chrysler, which has a massive unfunded liability, why do you have to look at the unfunded liability at all? Chrysler's operating earnings, plus or minus, are net after the amortization costs for that liability, that is already incorporated as a labor cost. To the extent that they can afford to hire workers, they can afford to pay them some amount of money for hourly pay, and some amount for pensions.

This whole thing should be kept in the area of an expense, of a cost. I was talking the other day with some people who were complaining about the multiemployer bill and wondered why was that legislation was so imminently and urgently necessary, much more so than the single bill, and the reason was, the termination insurance was going to come into effect, and the United Mine Workers Fund was going to be dumped on the PBGC, and the 50-cent rate was going to go to some huge amount, like $50, I said. Their comment was—and these were businessmen—their comment was, "$50 is an expense that relates to an annual contribution that we are making to one of the Teamster funds, of maybe $2,000 or $2,500 per year, per man."

That is an expense. We do not want more expense, but better that than when we have to close our business down, and sell it, because of bad business conditions—we get a letter from somebody that says, "You owe us $2 million, or $6 million, or $15 million."

Senator NICKLES. I appreciate your reservations on the contingent liability.

Mr. JACKSON. My point though in this testimony is there are other ways of getting at it. You say let us get after the people who dump, and I say fine, pass a law that gets after the people who dump and do not spread it so far that you get into all sorts of cases where people are selling businesses for perfectly normal reasons. They are not spinning off or trying to cheat the Federal Government. The sale of small businesses because of death or retirement goes on naturally. If you are really going to take advantage of a law like ERISA, you have to be pretty large in size to begin with. Because you have all sorts of expenses for lawyers, you have to establish a new corporation, you have the spinoff of pension plans, and this is very complex under ERISA. Little tiny companies are not doing this. You have all these sales of businesses that are going on for totally different reasons, and it strikes me that if we want a law that prevents wrongdoing, the law ought to put the wrongdoer in the position where he is not likely to do it. That is why we suggested here that what you really ought to have is a provision that says if anybody has dumped, he cannot have a new plan and he cannot expand any existing plan. And this would prevent somebody from dumping. It would prevent an AlloyTek from doing it; it would prevent a Facet from doing it because they would not be able to negotiate with their union to provide new benefits.

Now, that would fall on the wrongdoer. That would fall on the employer who has dumped or who has looked at dumping on the PBGC just in terms of the dollars and cents involved. He could not do it. He could not negotiate a contract with his union.

Senator NICKLES. Do you agree with the idea of moving the insurable event?

Mr. JACKSON. I do not think we have an insurable event and I think that what we have under the ERISA bill was a very carefully thought out thing.

Senator NICKLES. Voluntary.

Mr. JACKSON. It was a very careful balance. I was involved in the debate on ERISA from 1967 all the way up to 1974. I testified, in fact, before the House Labor Committee in 1972 on plan termination insurance and what it would take to make plan termination insurance work so you do not deal with these single sum liabilities so that when a Chrysler goes under, you suddenly need a billion dollars and you scare everybody in the world.

Senator NICKLES. Let me ask you a couple of questions now. On the insurable event, do you think it should be voluntary and PBGC comes into effect automatically under the terminations?

Mr. JACKSON. You could argue, Senator, that at the present time that the premium, as you call it, that is being paid to the PBGC by an organization is paid in order to let the company, that happens to overpromise in the pension area, back off to some extent. That is permitted under the multibill where plans that are in trouble are permitted to pull the benefit back. The guaranteed benefits are less than the vested benefits.

What this bill does is to say as soon as the employer promises a benefit he's stuck. A year later if he goes bankrupt, he cannot back off. He is committed to the whole thing. If the 30 percent is unreasonable, make it 40 percent. You see, I am a gradualist, I say we stand here and start from what we have, not from what we want to have, and we should ask "what can we do to improve this thing?" I do not really see all that many people deliberately dumping.

I agreed with the gentleman from AlloyTek, I think only two people have done it. These are the exceptions that prove the rule. People in America are generally pretty honest and, with pensions in particular, they are dealing with something that they want to get themselves and they want their employers to get. They are not playing games with them by and large.

Thirty percent of a company's net worth, paid in cash to the PBGC, can be a pretty significant slug, and just that drain on cash can put the employer in a position where he is out of business; if that is not a sufficient deterrent, make it 40 percent, make it 60 percent or 70 percent. Try the gradual approach and see what it takes to stop these things. I say what we ought to do is to study how the present program operates. The rate is not going to go from $2.60 to $5, or whatever it has to, because of people dumping. That is almost an incidental part of it.

Senator NICKLES. I think 28 percent was the figure.

Mr. JACKSON. Over half of the PBGC premium at the present time is for their administrative expenses. By the time you look at what the insurance is buying and you try to pare that down, you do not have that big a savings.

Senator NICKLES. Are you an actuary?

Mr. JACKSON. Yes.

Senator NICKLES. I have 37 employees participating, and that only costs me $100 a year. And so, yes, that is not a big deal. Our goal is to provide adequate protection for insurance plans, and yet we have seen the number of plans, we have seen more people getting away from defined benefit plans, we have seen this motion that you described earlier of this happening and increasing more. More people are getting out of the way because they do not want to mess with the programs. What we are doing is trying to change the direction of the growth that we had for 7 years under this plan under ERISA. We found and had testimony that was alluded to earlier that there are a lot of things that are good under the first two titles. Under title VI, which is the revision of the insurance provisions, we have had witnesses before us today. PBGC and myself are very concerned that what we have seen is just a couple of people getting under the carpet now, and if we do not change the law, if we do not make it illegal to do some of those things, then we are going to see a lot more of it happen.

Mr. JACKSON. I am in total agreement with you, Senator.

What I am talking about is how do you go about changing it so it stops there. If you go to a small businessman and you say you are now paying the $100 premium and this might go to $200 or $400, and we are going to change this and, in the process of that change, you put the small businessman in a position where he can't get credit or when he goes to sell his business, he cannot find a buyer, or if he dies, his widow, 14 years later, is hit with some massive assessments, you have not really helped anything. The cure is worse than the disease is what I am saying.

Senator NICKLES. We are willing, that is certainly not our intention.

Mr. JACKSON. I think something can be done and something ought to be done. I agree totally that people should not be permitted, as the gentleman from AlloyTek said, to look at this law and to look at all the technical details and to find out a legal way to dump a lot of their own pension liability on somebody else. I think that is wrong.

I agree with you that there is a moral aspect to that, and that moral aspect, I might add, is what probably prevents 99 percent of the small businessmen in the country, and the big businessmen in the country for that matter, from taking that approach.

But if you pass something, you should pass it on the basis that it hits the 1 percent that are not concerned and would dump. Do not pass a law that just massively says everybody is going to come in and have to report. Now, you have to have another actuarial evaluation done before you can sell your business.

Senator NICKLES. You have to have it with the defined benefit plan anyway.

Mr. JACKSON. You only have to have one every 3 years now. The more work that we have to do on the narrowing group of clients that we have, then the more likely it is that some successor in my company is not going to be able to pay my pension either. So I too am being very selfish about the whole business.

Senator NICKLES. I am going to conclude with that and apologize for the fact that we went farther than I had hoped, and many others had hoped.

We will be keeping the record open if any of you have additional comments and we would like to keep it open the other way for some question because it is certainly our intent, in the first place, on the contingent liability not to have that be an adverse effect.

I do think we have the exemption of 35 employees. They suggested moving it to an unfunded liability of one-half of a million dollars. I am in this size of business classification, too, and I would want to look at those figures if I was going to purchase that firm and let the buyer be aware or take a look at what we are looking at.

Anyway, for the record, we will be keeping the record open. Our next hearing scheduled for ERISA is January 26, when, we will deal with the fiduciary responsibilities and changes.

At this point I order printed all statements of those who could not attend and other pertinent material submitted for the record.

[The material referred to follows:]

Technical Comments on S. 1541

Submitted by the National Coordinating Committee for Multiemployer Plans

The National Coordinating Committee for Multiemployer Plans (the "Coordinating Committee") is a nonprofit corporation which was organized to represent the interests of the eight million participants in multiemployer plans. The Coordinating Committee represents over 100 affiliates including major international unions, national pension and welfare plans, and local multiemployer trusts.

As the Chairman of the Coordinating Committee has testified, we believe that this is not an appropriate time for legislation modifying ERISA. There are, however, certain changes which we would like to see incorporated should legislation in this area go forward at another time. These changes would take account of the special nature and problems of multiemployer plans.

I. Section 3101: Supplemental Pay Plans

By treating certain supplemental pay arrangements as welfare plans instead of pension plans, Section 3101 of the bill would exempt such arrangements from the provisions applicable only to pension plans. To take account of the special problems of multiemployer plans, any legislation in this area should be modified as described below.

First, the restriction that benefits be paid entirely out of the general assets of the employer is unworkable in multiemployer situations. It is the nature of most industries served by multiemployer plans that workers move from employer to employer, making it impossible for any given employer to maintain a plan providing meaningful benefits. In these industries, the only feasible arrangement is for plans to be funded through a multiemployer trust. Contributions to such trusts can then be made at a designated rate pursuant to collective bargaining agreement. Such contributions go to provide benefits for all eligible participants, regardless of who their employers may have been. Another reason for a trust is that the contributions made during a contract period may well exceed benefits paid, creating a reserve. There must be some entity to hold such reserves for the following period. It should be stated, in legislative history or otherwise, that use of a trust in such manner is a proper purpose under section 501(c)(9) of the Internal Revenue Code.

Second, we believe any legislation should grant flexibility in the establishment of limited-duration reduction-in-force arrangements. From time to time, employers contributing to multiemployer plans may find it useful to effect a desired or necessary reduction in force by providing supplementary payments to those employees who retire within a prescribed and limited period of time. Such an arrangement may offer a lifetime payment in addition to the regular pension to those who retire within the two-year or three-year contract period. Under present law the ERISA vesting requirements for pension plans may pose questions about these arrangements. We believe these questions should be resolved in favor of such arrangements. The limited duration of such supplemental offers would serve to guarantee that they would not be used to avoid the basic goals of ERISA.

Third, it would be desirable for participants to be advised of the limitations of any payments promised or received under such arrangements, including the fact that they are not covered by the vesting provisions of ERISA. The Coordinating Committee therefore suggests a requirement for such notice in any legislation.

The regulation on supplemental pay plans proposed by the Labor Department pursuant to the 1980 multiemployer legislation is unduly restrictive in other respects that should be corrected in any new legislation on this subject. For example, the employer's commitment should not be limited to one year in multiemployer contexts. Contribution commitments under a multiemployer arrangement may run for a two-year or three year contract period, or longer, and the commitment to pay benefits may last for more than one year. Also there is no reason to prohibit supplemental payments to persons who have been retired for less than two years. If this section of the bill were enacted in its present form, it could conceivably be interpreted as approval of all other aspects of the Labor Department's proposed regulation.

II. Section 3207: Summary Annual Report

ERISA section 104(b)(3) currently requires a plan administrator to furnish to each participant and to each beneficiary receiving benefits a summary annual report within 210 days after the close of the plan's fiscal year. Section 3207 of the bill would amend ERISA section 104(b)(3) to require a plan administrator to post the summary annual report (including a statement of the participants' rights to the annual report, a summary plan description, and other plan information) at the principal work sites of participants. The Secretary of Labor would be directed to issue regulations providing for alternative methods of publication including, but not limited to, distribution of the summary information through company or union newsletters. In addition, this section of the bill would statutorily limit the maximum amount that a plan could charge for a complete copy of the annual report to $10.00.

The Coordinating Committee recommends that any legislation in this area incorporate the following changes to take account of the special nature and problems of multiemployer plans.

First, this section of the bill as written would apply only to pension plans. The term "employee benefit plan" should be used in lieu of "pension plan" so as to include welfare plans within the coverage of this section.

Second, direct distribution of the summary report by multiemployer plans to participants should remain as a statutory alternative method of distribution so that multiemployer plans that prefer to continue distribution directly to participants need not wait for Labor Department regulations in order to do so.

Third, for multiemployer plans in some industries, such as the construction industry, posting at the principal work sites may not be a practical method of distribution because of the short-term nature of many projects. In the construction industry the local union office or hiring hall is the focal point of employment activity because it is generally through the local union office or hiring hall that workers are assigned or referred to employers and projects. The posting of summary annual reports at the local union office or hiring hall would be comparable to posting at the principal work sites. Accordingly, this section of the bill should specifically authorize, for multiemployer plans, posting at the local union office or hiring hall as an alternative method of distribution. We note that proposed ERISA section 111(a)(3)(B) contained in section 3212 of the bill provides for the posting of certain required information at local union offices. Further recognition of the legitimacy of such a distribution method is contained in section 2520.104b-1(3)(iii) of current Labor Department regulations which provides for the maintenance of plan documents at local union offices.

Finally, we oppose the statutory $10.00 limit on charges for complete copies of the annual report. We believe that the current ERISA section 104(b)(4) restriction on charges is adequate. Given the effects of inflation, the setting of a maximum charge is better suited to the regulatory process.

III. Section 3208: Simplification of Notice to Interested Parties

The Coordinating Committee does not oppose simplification of the notice process, but, at least in terms of the timing and publication of the notice, we believe that the current Treasury regulations[1/] are adequate and that these sections of the bill would represent neither a simplification nor an improvement of existing law. These sections would expand the time period during which the notice must be posted. We are concerned that the 60 day requirement would create unwarranted procedural problems for plans and would cause unproductive delays in obtaining an IRS review and determination.

We are further concerned that the alternative methods of publication of the notice provided for in the current Treasury regulations be preserved and legislatively sanctioned. Those regulations have worked well and represent a reasonable balance between the rights of interested parties and the needs of plans. The alternative publication methods provided for in the current regulations are consistent with the intent of sections 3208, 4202, and 3207 of the bill to simplify the notice and disclosure requirements.

IV. Section 3212: Alternative Methods of Disclosure

This provision would add a new section 111 to ERISA, prescribing a detailed procedure for multiemployer plans to use a special alternative means of meeting certain ERISA disclosure obligations, if the plans choose to do so. The procedure would authorize multiemployer plans to furnish information to plan participants by providing the documents to their employers, who would in turn make the distribution directly to the covered employees.

Under current law and regulations, plans may distribute disclosure material to participants by means that are reasonably calculated to ensure actual receipt of the information by the participants. In appropriate situations, multiemployer plans are able to satisfy this requirement with the cooperation of the participants' employers in ensuring adequate direct distribution. It does not appear to be either necessary or advisable to change the law in this regard specifically for multiemployer plans.

V. Section 3302: Suspension of Benefits

Section 3302 of the bill would allow plans to suspend benefits to workers who have not retired but who continue to work on an irregular basis, and would specifically include self-employment as work subject to the suspension rules. It would also permit plans, as a limited deterrent to retirees who fail to report reemployment, to suspend benefits for a period, not to exceed 12 months, in addition to the period of reemployment.

Because of the special nature of multiemployer plans, the ability of plans to adopt reasonable suspension of benefit rules is a subject of vital concern. The Coordinating Committee has made a number of submissions and has met with Labor Department officials many times on the Department's proposed regulations on this subject. Specific concerns we have with this section of the bill include the following.

1. The Committee believes that any legislation amending section 203(a) should itself explicitly permit reasonable suspension rules, without requiring plans to wait for administrative regulations on the subject. Any regulations promulgated thereunder should be for the purpose of facilitating reasonable plan rules rather than circumscribing the intended policy of Congress.

2. Any amendment of section 203(a) should include an amendment of section 203(a)(3)(B)(ii) to provide as follows:

> "(ii) in the case of a multiemployer plan, in the same industry, or the same trade or craft, and in the same geographic area."

The need for this amendment is described below.

Multiemployer plans are generally based on collective bargaining agreements covering certain employees in a particular trade or craft, or in a particular industry. However, multiemployer plans do not necessarily cover employees in a particular craft or trade _within_ a particular industry. It is possible to interpret the current provisions of ERISA section 203(a)(3)(B)(ii) to require that a retiree be engaged in both the industry and trade or craft in which he was formerly engaged, before a plan can suspend benefits. Such a requirement would make it almost impossible for multiemployer plans to determine whether suspension of benefits is warranted.

The work coverage of a multiemployer plan is generally defined either by the product produced, or by the nature of the service provided. In the former case, workers are covered without regard to their trade or craft. For example, a plan maintained for hard rock miners may encompass laborers, carpenters, electricians, maintenance workers, truck drivers, and other skilled and unskilled classes of workers. The designation of trade or craft is essentially meaningless in this context because the multiemployer plan covers any trade or craft which occurs in the industry.

On the other hand, many multiemployer plans are based on a particular craft. Such multiemployer plans cover carpenters, plumbers, sheet metal workers, electricians, laborers, plasterers, musicians, etc. These plans often embrace all persons employed in a particular craft within the scope of a collective bargaining agreement, regardless of the product or service sold by the employer. Thus, a covered carpenter, plumber, or electrician may be employed in original construction, construction alteration, building maintenance, or by almost any large employer in a variety of industries. For such "craft" multiemployer plans, the "industry" is irrelevant.

3. Any legislation in this area should explicitly permit multiemployer plans to recoup benefits improperly made to reemployed retirees, by offsetting future benefit payments to those retirees. Multiemployer plans should be permitted to recoup the full amount owed plus interest.

4. Multiemployer plans should be able to define the circumstances of reemployment justifying benefit suspension in the manner that most appropriately fits the situation faced by the plan. We regard a statutory or regulatory definition involving a certain number of hours of service as arbitrary in view of the differing factual contexts confronting plans.

5. Any suspension rules should permit multiemployer plans to suspend benefits for longer than the months of actual reemployment. Absent a plan's ability to do so, a retiree has no incentive to comply with suspension rules.

6. Any legislation in this area should make clear that suspension rules are not applicable to the employee who merely continues working for the same employer past normal retirement age. A contrary position, as may be endorsed by the Department of Labor regulations, would cause enormous financial and administrative burdens for multiemployer plans.

7. Any legislation in this area should make clear that suspension rules are not applicable to the employee who merely continues working past normal retirement age. The proposed Labor Department regulations may be read to endorse a contrary position.

8. In industries where intermittent employment is the norm, it should be made clear that an inactive period of several months or more does not mean that a participant of normal retirement age or older has actually retired. Plans should not be required to pay benefits during periods of inactivity if the participant still works on a regular basis.

VI. Section 3307: Years of Service, Years of Participation, and One-Year Break in Service at Seasonal Establishments

The bill would require plans in which a majority of employees are seasonal to use 500 hours, rather than

1,000 hours, for purposes of defining a year of service, and to substitute 250 hours for 500 hours in the definition of a break in service. The bill also defines "seasonal employee" and "seasonal establishment." A "seasonal employee" would be defined generally as any participant who works on a full-time basis less than 1000 hours in a year, and who is employed at a seasonal establishment. A "seasonal establishment" would be defined generally as an establishment at which employment is limited by regular and recurring climatic conditions directly and physically affecting the ability of the establishment to engage in its normal functions, and at which a majority of the employee-hours completed by participants in pension plans established or maintained by such employer is performed by participants who complete on a full-time basis not more than 1,000 hours of service during any 12-month period at that establishment.

The Coordinating Committee is very concerned about the broad definition of "seasonal establishment." Such a sweeping definition may subject industries and employers to treatment as seasonal where it would be quite inappropriate to do so. For example, it might be possible under the bill's definition to identify some parts of the construction industry as seasonal. The construction industry is not treated as seasonal in other contexts, and it would disrupt labor-management relations and the collective bargaining process to suddenly classify such industries as seasonal.

VII. Section 3308: Delinquent Contributions

Section 3308 of the bill addresses an issue of concern to many multiemployer plans. This section would provide that a multiemployer defined benefit pension plan need not award credit for hours of service for which the participant's employer does not make the required contributions to the plan. However, the bill would not resolve this question in the context of defined contribution plans, where the problem is even more acute.

Defined contribution or "individual account" plans provide for fixed employer contributions established through collective bargaining, which are credited to the individual accounts of participants. Credits to the accounts of participants are generally based upon the amounts actually contributed to the plan so that participants receive no credit for delinquent contributions except to the extent such contributions are subsequently collected. In an individual account plan, it is particularly difficult to see where the money required to give credit for contributions that are never received is supposed to come from.

The Internal Revenue Service is considering issuing a ruling to the effect that a defined contribution plan would not meet the requirements of Code section 401 unless the plan credited the accounts of participants for all required contributions, whether collected or not. Such a ruling could result in the disqualification of most multiemployer defined contribution plans.

The proposed IRS position would disrupt collective bargaining relationships and would be detrimental to the hundreds of defined-contribution multiemployer plans negotiated to provide for the financial security of working men and women. These plans operate with relately low administrative costs and have been successful in achieving low delinquency rates. Any legislation in this area should specify that participants' accounts in defined-contribution plans need be credited only for contributions actually received by the plan.

VIII. Sections 3310 and 4310: Alimony and Support Payments

The Coordinating Committee believes that any legislative clarification of the applicability of the ERISA and Internal Revenue Code anti-alientation provisions to state court domestic relation orders should include, in addition to the provisions in the bill, the following features.

First, any legislation should clarify that any non-participant awarded a portion of a participant's pension benefits under a state court order does not thereby become a plan participant for purposes of ERISA. Treatment as plan participants would impose unwarranted costs on plans in terms of, for example, additional termination insurance premiums and disclosure requirements. Given the high divorce rate in this country, the participant populations of plans could dramatically increase without corresponding gains in covered employment and contributions if those who receive a portion of a participant's benefits are themselves deemed to be plan participants.

Second, many state court orders specifically authorize the affected plan to deduct from the participant's benefits a reasonable administrative fee to cover the plan's cost of splitting the benefits and maintaining records on the person sharing the participant's benefit. Such administrative fees should be specifically authorized in any legislation on this subject.

IX. Section 3503: Refund of Mistaken and Certain Other Contributions

The Coordinating Committee opposes section 3503(c) of the bill. This section provides in part that any determination by a plan administrator of a multiemployer plan prior to the enactment of S. 1541 that a contribution or payment had been made by mistake of fact or law shall be considered to have been made on such date of enactment. The effect of this provision would be to reopen all past determinations with respect to return of contributions and payments. This would resurrect issues and decisions that parties have long since laid to rest. Undue pressures would be brought to bear on trustees regarding matters that were previously settled under existing statutory provisions.

X. Sections 6202 and 6303: 15-Year Funding

Finally, we oppose the requirement, set forth in sections 6202 and 6303 of the bill, that unfunded, vested liabilities be amortized over a fifteen-year period. Such a requirement would be highly inappropriate for multiemployer plans. Under the 1980 multiemployer legislation, such plans are already required to meet a comparable standard known as the Minimum Contribution Requirement or MCR. MCR already requires multiemployer plans to fund the vested benefits of persons in pay status over a ten-year period and the vested benefits of all others over a twenty-five-year period. The adequacy of multiemployer plan funding has thus been comprehensively dealt with in recent legislation. Superimposing an additional requirement that vested benefits be amortized over a fifteen-year period would be both unnecessary and complicating, such a requirement could be severely disruptive to labor-management relations and the entire collective bargaining process, and would, in every case, add an unnecessary administrative cost for plans.

Statement of the National Rural Electric Cooperative Association to the Subcommittee on Labor of the Senate Committee on Labor and Human Resources

Hearings on S. 1541, the Retirement Income Incentives and Administration Simplification Act of 1981

The following statement represents the viewpoints of the National Rural Electric Cooperative Association ("NRECA") with respect to Title VI of the Retirement Income Incentives and Administration Simplification Act of 1981 (S. 1541 or the "Bill"), with particular emphasis on those provisions of Title VI which would affect the federal termination insurance program applicable to multiple-employer plans that are not the result of collective bargaining.

NRECA is interested in, and generally supportive of, many of the changes in the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code (the "Code") that would be effected under Titles I through V of S. 1541. In view of the somewhat unusual attributes of NRECA and its retirement program (more fully described below), however, NRECA believes that the Sections of the Bill on which its comments would be most helpful are the Sections relating to termination insurance and multiple-employer plans and, accordingly, its comments are thus confined.

I. BACKGROUND

A. Description of NRECA and its Member Cooperatives

NRECA is an association composed of over 1,000 rural electric cooperatives located throughout the United States. The association is tax-exempt under the provisions of Section 501(c)(6) of the Code, and member cooperatives are tax-exempt under the provisions of Section 501(c)(12) of the Code.

The members of NRECA share a number of characteristics in common. They are organized under the Rural Electrification Act of 1936 and are regulated by the Rural Electrification Administration of the federal government as well as by state utility commissions. The principal purpose of each cooperative is the delivery of electricity to rural areas. Since the members of NRECA are cooperative organizations, each cooperative is, by definition, governed by its own membership and a board of directors elected by such membership. Although they are bonded together through NRECA for service purposes, they do not come under the management or control of NRECA.

Some of the cooperatives that belong to NRECA are unincorporated, and some of them are incorporated under state laws. Most of them are non-unionized but a few of them are parties to collective bargaining agreements where employee benefits are a subject of bargaining, usually within the parameters of NRECA-sponsored plans. Most of the cooperatives are small employers with only approximately thirty-five employees, but a few of them have one hundred or more employees.

B. Description of the NRECA Retirement Program

(1) In General -- As a service to its member cooperatives, NRECA has for several years sponsored and administered certain employee benefit programs. The programs currently include a group insurance trust maintained pursuant to Section 501(c)(9) of the Code and two tax-qualified retirement plans. The retirement plans are the Savings Plan for Employees of National Rural Electric Cooperative Association and its Member Systems (the "Savings Plan") and the Retirement and Security Program for Employees of National Rural Electric Cooperative Association and its Member Systems (the "Retirement and Security Program"). The Savings Plan is a defined contribution plan and, accordingly, is not subject to the termination insurance program. The Retirement and Security Program is a defined benefit plan. Approximately 800 cooperatives, covering approximately 36,000 employees, participate in it.

(2) Features of the Retirement and Security Program -- The Retirement and Security Program is considered a master

plan for tax qualification purposes. This means that there is one basic set of plan specifications and one trust agreement and fund that are common to all cooperatives which elect to participate in the Program. Certain provisions of the Program vary from cooperative to cooperative, however, depending on the particular cooperative's choice at the time it executes an adoption agreement evidencing its election to join the Program. In order to receive the approval of the Internal Revenue Service, a two-step procedure is followed. First, the basic specifications are submitted to the National Office which approves the form of plan. Then each cooperative submits its own adoption agreement and employee data to the applicable District Director for a determination that the Program is qualified with respect to that particular cooperative.

Established in 1948, the Retirement and Security Program is the primary pension plan for NRECA member cooperatives. Each cooperative that participates in the Retirement and Security Program may elect options in the adoption agreement with respect to various provisions of the Program. Since 1978, when the Program was substantially revised, there has been a range of retirement benefit options. First, each cooperative may select whether its normal retirement age shall be 65, age 62 or 30 years of service or age 62, if earlier. Secondly, when the Program was revised in 1978 it was changed to become a unit benefit plan, and each cooperative was given the right to decide the benefit level as a percentage of compensation and whether the unit benefit put in place in 1978 shall apply to all of an employee's service (including service prior to 1978) or only to future service (in which case the employee's benefit for service prior to 1978 is determined under the pre-1978 provisions).

Transfers of employees from one cooperative to another are not particularly common. NRECA estimates that in 1980, for example, less than 1% of the total employees covered by the Program transferred from one cooperative to another. When such a transfer is made to another cooperative enrolled in the Program, the employee's participation in the Retirement and Security Program is continued uninterrupted, and he becomes subject to all of the provisions of the Program that have been elected by the cooperative to which he is transferred except that the benefits payable to him with respect to his years of service with the cooperative from which he is transferred generally are limited to the level of benefits elected by the transferor cooperative.*/ Thus, for example, assume an employee transferred from Cooperative A with a normal retirement age of 65 and a benefit equal to 1% of compensation for each year of service. He is transferred to Cooperative B with a normal retirement age of 62 and a benefit equal to 3% of compensation for each year of service. The employee would be able to retire at Cooperative B's earlier normal retirement age and would receive a 1% benefit for his years of service prior to the transfer and a 3% benefit for his years of service subsequent to the transfer.

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*/ It should be noted that each cooperative was given the opportunity in its adoption agreement to make an exception to the general rule for employees transferred prior to a particular date if its level of benefits was greater than the transferor's level of benefits.

(3) Funding of the Program -- Funding is based on the entry age normal cost method. Each member cooperative is billed by NRECA at the beginning of the calendar year for its share of the Program's costs. Costs are determined by the number of employees of each cooperative and the benefit provisions of the Program elected by it, including its past service provisions. Net assets available to pay benefits on December 31, 1980 totalled $514,871,747, which represents an increase of 23% over the prior year. The actuarial valuation report for 1981 shows an excess of assets over present value of total vested benefits at 16%.

These favorable funding ratios have existed over a decade. Since the inception of the Program in 1948, the pension trust was able to discharge its obligations fully to plan participants and beneficiaries. In short, the Retirement and Security Program historically has been fully funded.

(4) Withdrawals from the Program -- A cooperative which is participating in the Retirement and Security Program may decide to discontinue its participation. In virtually all such cases the purpose of the cooperative in discontinuing its participation in the Retirement and Security Program is to establish its own retirement program (which in some cases may be a defined benefit plan and in other cases a defined contribution plan).

When a cooperative discontinues its participation in the Retirement and Security Program, both the cooperative and NRECA have an interest in segregating the assets attributable to the cooperative's employees' benefits from the Program. The cooperative may wish to transfer the assets to its new plan to use in funding the benefits thereunder or it may want to distribute benefits to participants when it discontinues its participation in the Retirement and Security Program and establishes its new plan. It also does not want to continue to be responsible for funding under the Retirement and Security Program. NRECA is interested in insuring that the cooperative's employees receive the benefits to which they are entitled under the Retirement and Security Program but, because the cooperative is establishing a new program and because of the administrative problems involved, it does not wish to bear any ongoing responsibility for the provision of benefits to the cooperative's employees nor continue to bill the cooperative for Program costs.

After ERISA was passed, NRECA explored these issues under the applicable requirements of the Code and ERISA and informally conferred with representatives of the Pension Benefit Guaranty Corporation (the "PBGC") with respect thereto. It was determined that the best procedure, both in terms of equity to the employees of the cooperative discontinuing its participation in the Retirement and Security Program and the employees of the other participating cooperatives, and in terms of ease of administration, was to segregate assets from the Program and deliver them over to the plan of the withdrawing cooperative. Such withdrawal was not considered a termination of the Program. Rather, after this withdrawal the plan of the withdrawing cooperative was considered a single employer plan and any liability for unfunded vested benefits on a subsequent termination of that plan was the responsibility of the individual cooperative.

The procedure established in the early days of ERISA fitted nicely with the regulations under Section 414(l) of the Code regarding merger and transfer of plan assets.

Under those regulations a de minimis rule was provided to cover cases when a spinoff involved 3% or less of the plan assets. This rule allows the spinoff of assets from the Program to the cooperative's new plan in an amount equal to the accrued benefits of the employees of the withdrawing cooperative, whether or not such accrued benefits are vested. To date, compliance with the de minimis spinoff rules has been possible in all cases because the Program is well funded and because the amount of assets spun off in any one year has never exceeded 3% of the total assets of the Program.

After a spinoff has occurred, the cooperatives that continue to participate in the Program have no further liability with respect to the employees covered by the spinoff plan, and the cooperative that maintains the spinoff plan has no further liability with respect to the employees covered by the Program.

II. COMMENTS ON TITLE VI OF S. 1541

Objections of NRECA to Title VI of the Bill center on the provisions of Section 6118 which relate to the withdrawal of an employer from a multiple-employer plan. If enacted in its present form, Section 6118 would adversely affect the operation of the Retirement and Security Program and impose unnecessary liabilities on each of the participating cooperatives. The marketing of the Program over the years has been based on a clear understanding between new members and NRECA that upon discontinuance, there remains no lingering obligation to each other.

A. Comparison With Multiemployer Plans

The proposals set forth in Section 6118 of the Bill are obviously based upon the provisions of ERISA applicable to the withdrawal of an employer from participation in a multiemployer plan. It is submitted that there is no parallel between multiemployer plans and the NRECA Retirement and Security Program. The Program is comparable to a multiemployer plan only insofar as more than one cooperative contributes to the Program and the contributing cooperatives are engaged in the same industry. There are several distinguishing characteristics of the NRECA Retirement and Security Program, however.

First, although the unionized employees of a few of the participating cooperatives collectively bargain for selected benefits within the Program, the vast majority of cooperatives are non-union. The existence of unionized employees is absolutely essential to a multiemployer plan. By statute, a multiemployer plan is defined as a plan "maintained pursuant to one or more collective bargaining agreements between one or more employee organizations and more than one employer . . .". (Sec. 4001(a)(3)(B), ERISA)

Secondly, employers enter a multiemployer plan because participation is a matter of collective bargaining and an employer is required to participate only as long as it is a party to the collective bargaining agreement. On the other hand, an employer comes into the NRECA Retirement and Security Program by unilateral action taken to provide a plan only for its own employees.

Third, historically the multiemployer plan retains the obligation to pay benefits after an employer withdraws from a multiemployer plan. By contrast, if a cooperative decides to discontinue participation in the Retirement and Security Program, it withdraws from the Program and the employer's allocable share of Program assets are transferred to a plan continued by the cooperative. The employees of a withdrawing employer no longer look to the Program for payment of benefits, but rather to the continuing plan of their employer.

Fourth, while many multiemployer plans historically have been inadequately funded, the NRECA Program has for most of its history been fully funded.

Finally, and perhaps most importantly, the Program is more like an aggregate of single employer plans than one massive Program for the industry due to the fact that each participating cooperative is free to set its own benefit level and type of plan (within master plan provisions) and the fact that most employees work for only one participating cooperative during their working careers rather than transferring among cooperatives. Employees regard the Program as one sponsored by their own individual employer and not a Program of the industry.

B. Specific Comments

NRECA has the following specific comments on the Bill:

(1) NRECA objects to the proposal contained in Section 6118 of the Bill to make a multiple-employer plan contingently liable for benefits of a withdrawing employer. It is submitted that if a cooperative decides to withdraw from the Retirement and Security Program, the Program should not be responsible for the future of that cooperative's benefit promises. Once the cooperative withdraws, and there is a transfer of assets and liabilities as provided in proposed Section 4063(e) of ERISA, the NRECA Retirement and Security Program has no further control over the investment and management of those relinquished assets. It would be inequitable to impose further responsibility for the payment of benefits on the Program since the level of benefits in the plan of the withdrawing cooperative is a matter of the cooperative's choice. It is not set by the Retirement and Security Program.

It is recognized that under proposed Section 4063(e)(2)(B), the liability of the multiple-employer plan cannot exceed one of two limits, one of which is an amount equal to the unfunded accrued benefits transferred. Because of the present high degree of funding in the Retirement and Security Program and the fact that assets equal to the full accrued benefits are transferred out when a cooperative withdraws from the Program, the Program would have no liability under the proposed rule. It is possible, however, that this situation could change due to some cataclysmic market condition that results in a drop in the value of plan assets or other reasons that would affect all like programs. The point is that, as a matter of principle, NRECA does not believe that there should be any contingent liability, considering the nature and history of the Retirement and Security Program. When a cooperative withdraws it should be treated the same as an independent employer, for in fact the plan is operated solely by the withdrawing employer following withdrawal.

It is recognized that not all multiple-employer plans are composed of employers with as much latitude in prescribing benefit levels for its own employees as in the NRECA Program. Therefore, it may not be appropriate to completely delete from the Bill the contingent liability provisions that may be applicable to those multiple-employer plans based on collective bargaining, for example. At the very least, however, NRECA unequivocally recommends that a provision be included which allows the PBGC to exempt individual multiple-employer plans from the contingent liability provisions, upon an application from the plan and a showing that, on the basis of the facts and circumstances, contingent liability is not appropriate.

(2) If the foregoing suggestion is not adopted, there are two modifications which should be made in proposed Section 4063(e):

(a) The contingent liability of the multiple-employer plan following a transfer of assets and liabilities should be of limited duration. As drafted, proposed Section 4063(e) would continue the contingent liability forever. For reasons stated above, this is an unreasonable proposal. It is suggested that the contingent liability should in no event continue after five years have elapsed from the date of withdrawal.

(b) Proposed Section 4063(e)(2)(C) permits the PBGC to waive the contingent liability of a multiple-employer plan upon a showing that the interests of plan participants and beneficiaries and the interests of the PBGC are adequately protected without the application of contingent liability. Presumably, however, such a waiver could not be obtained until an insurable event has occurred with respect to the withdrawn employer's plan. This might occur several years from the date of the withdrawal and would result in great uncertainty as to the potential liability of the multiple-employer plan.

A provision should be added which would allow the multiple-employer plan to obtain a waiver from contingent liability at the time of the withdrawal of an employer if, on the basis of the facts and circumstances at that time, it appears that the interests of participants, beneficiaries and the PBGC are adequately protected.

(3) The amount of liability imposed under Subsection (b) of proposed Section 4063 of ERISA on an employer who withdraws from a multiple-employer plan is equal to the plan's unfunded vested benefits that are attributable to the participants' service with the withdrawing employer (plus those unfunded vested benefits that are attributable to service with employers that are not currently participating in the plan which, in NRECA's case, probably would be nonexistent). This amount generally must be paid by the withdrawing employer to the plan in fifteen annual installments.

Under proposed Section 4063(e)(1)(B) however, the withdrawing employer may demand that the plan transfer to the withdrawing employer's new plan the full amount of all accrued benefits attributable to service with the withdrawing employer (if such transfer is in accord with the spinoff rules under Section 208 of ERISA and Section 414(1) of the Code).

This is an inequitable result. While it is true that if the multiple-employer plan transferred the full value of accrued benefits to the withdrawing employer's plan, it would no longer have any contingent liability to the PBGC under Subsection(e)(2)(B) of proposed Section 4063, this advantage to the multiple-employer plan does not counterbalance the fact that a transfer under Subsection (e)(1)(B) could significantly deplete the assets of the multiple-employer plan that are attributable to the accrued benefits of the remaining employers' plan participants. The situation could be particularly egregious in the case of the NRECA Program since each employer sets its own benefit level and the withdrawing employer may have significantly increased its benefit level (and accrued liability) in the last several years preceding a withdrawal.

Further, Subsection (e)(2)(B) allows a contributing sponsor to select against the multiple-employer plan in requiring the sponsor of the multiple-employer plan to transfer on demand the full value of accrued benefits. The sponsor of the multiple-employer plan should be permitted the latitude and right to transfer or not to transfer plan assets, in accordance with master plan provisions, in order to discharge his fiduciary obligations to other participating employers and their employees. Therefore, Subparagraph (B) should be deleted and Subsection (e)(1)(A) changed and expanded as follows:

> "(e)(1) A plan sponsor of a multiple-employer plan may transfer, upon the request of a withdrawing contributing sponsor, those assets and liabilities attributable to service with that contributing sponsor, to another single-employer plan if the transfer satisfies section 208 of this Act, section 414(1) of the Internal Revenue Code of 1954, and provisions of the multiple-employer plan."

If retained, however, proposed Section 4063(e)(1)(B) should be amended to provide that as long as a withdrawing employer has any liability to the multiple-employer plan under Section 4063(b), the most that the employer can demand from the multiple-employer plan under Section 4063(e)(1)(B) is a transfer of the value of the vested benefits attributable to service with the withdrawing employer. The objectionable words "shall transfer" should be ameliorated to "may transfer".

Alternatively, proposed Section 4063(b) should be amended to impose a withdrawal liability on the withdrawing employer equal to the full amount of the accrued benefits attributable to service with it.

All references in proposed Section 4063 to "accrued benefits" and "vested benefits" should be reviewed carefully to remove the inconsistencies in the present application of these terms.

(4) It is suggested that the Bill contain some provision for setting the premium due to the Pension Benefit Guaranty Corporation on the basis of the level of funding of the plan. One of the objections to the present method of determining premiums is that it imposes a cost on plans that is entirely unrelated to the likelihood of a plan being terminated and the federal government having to bear part of the cost of unfunded vested benefits. In essence, well-managed plans help pay for the cost of those plans which are not well managed. Accordingly, it is suggested that a provision for risk-related premiums be added to the Bill.

For example, if a plan has been fully funded for a minimum of five consecutive plan years, premiums could be frozen at the average premium rate in effect for such five consecutive years while floating with current basic-benefit guarantee levels. The premium would continue at that rate until the earlier of the date an adequate funding test was not met or the expiration of five more consecutive years. An adjustment of level premium based on the lowest rate increase of effective premiums during the frozen period seems reasonable for the next consecutive five-year period. The adequate funding test would be met unless in any one of the subsequent five consecutive years, the level of funding dropped to less than 90% of the liabilities in that plan year.

Members of the staff of NRECA will be happy to meet with the Subcommittee on Labor or staff members thereof to discuss the foregoing comments.

Respectfully submitted,

NATIONAL RURAL ELECTRIC
COOPERATIVE ASSOCIATION

By M.O. Wood

American Optometric Association

November 23, 1981

Honorable Don Nickles
Chairman
Subcommittee on Labor
U.S. Senate
Washington, D.C. 20510

Dear Senator Nickles:

On behalf of the American Optometric Association, I would like to submit the following comments on S. 1541, the Retirement Income Incentives and Administrative Simplification Act of 1981. These comments will be directed to Section 3605 of the bill, which amends Section 514 (preemption) of ERISA.

To begin with, we accept the premise that in order to assure the protection of pension plans, some preemption of state laws is required. We also note that most employee benefit plans include not only pension coverage, but also health care benefits, and to that end ERISA sets standards for the protection of the employee benefit plan as a whole.

However, we would like to bring to your attention a problem which has arisen in the area of interpretation of federal preemption of state laws. Specifically, a number of employee benefit plans which are not insurance plans -- typically, self-insured plans -- have refused to permit their beneficiaries to select a doctor of optometry for covered services within their license. In some 90% of the states the freedom to select an optometrist or a physician for covered services within the scope of practice of both is guaranteed by State law under insurance plans and in government health programs; I might add that this is also guaranteed for federal employees under FEHBA. However, these particular plans have cited the fact that they are not insurance plans, and that they are subject only to ERISA which specific has no freedom of choice provision and would, absent such a provision, preempt any state legislation to this effect.

We believe that ERISA was never intended by the Congress to regulate how the health professions are practiced in the respective states. The great body of law in the states holds that persons shall be able to select a health professional from any discipline whose scope of licensure, as determined by each state, enables him or her to perform a service in question. This body of law was created by the various state legislatures in response to built-in marketplace biases, e.g., the medical referral infrastructure.

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Its purpose remains clear: to assure access to the various professions as per their licensure, and thus to assure competition. The net effect of preemption of this body of law is to remove persons covered by employee benefit plans -- a major segment of the population -- from this anti-monopoly requirement.

I must emphasize that we are not talking about the issue of mandated benefits, which is addressed on page 145 (lines 9-17) of the bill. This is a separate question from the assuring of access to duly licensed health professions for covered benefits.

RECOMMENDATION

We note that page 146 (lines 6-14) addresses the spirit of a solution to this problem. That language affirms that state freedom-of-choice laws affecting insurance are not preempted. However, that language does not go far enough in that it would not apply to self-insured plans and we would respectfully recommend that the following language be substituted:

> "A provision of state law that defines which of the health professions may perform what services, and under which circumstances a person may obtain covered benefits from a provider licensed or certified by a state to perform a health care service, is not preempted.

We note that the freedom-of-choice savings provision currently in the bill was not opposed by any witness at the recent hearings of your subcommittee. In recommending this broader version for your consideration, we believe that it would not constitute a burden on plans but would assure that a significant segment of the American people would have access in the marketplace to all professions licensed to provide a particular service. Also, we believe that respect for state action in this relatively narrow area would not break down the doctrine of preemption, but would be consistent with the intent of ERISA to protect the security -- and availability -- of benefits to persons covered by employee benefit plans.

Please feel free to contact either David Lewis or Howard Menaker of this office or myself should you require further information.

Sincerely,

James W. Clark Jr.

James W. Clark, Jr.
Director
Washington Office

JWC:sm

cc: Honorable Martin Frost
(c/o Bonnie McLellan)

STATEMENT BY THE HONORABLE MARTIN FROST
SUBMITTED TO THE SUBCOMMITTEE ON LABOR
SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES
November 24, 1981

Mr. Chairman, I appreciate this opportunity to submit my statement on the ERISA legislation your subcommittee is currently considering.

First let me say that I consider the 1974 enactment of ERISA a giant step forward in the protection of employee pension and health benefits.

But, as is sometimes the case with landmark legislation, with the benefit of hindsight we have uncovered a few areas where ERISA should be modified in order to optimize its effectiveness.

One of those areas relates to its preemption clause. ERISA's architects designed the preemption provision to allow employers to offer a wide and comprehensive range of health care and pension services without having to contend with a multitude of individual state laws. And preemption for the most part has achieved the desired objective.

Unfortunately, one of the unintended by-products of preemption has been to allow ERISA to supercede state laws which protect a beneficiary's right to select medical care. I am referring to the state insurance codes which offer consumers a "freedom of choice" among health care practitioners. At this time, a total of 46 states and the District of Columbia have insurance codes which embody some form of the "non-discrimination in insurance" concept. These laws require insurance carriers to reimburse either the beneficiary or the practitioner for a delivered health service. For example, an insurance contract which provides coverage for foot care must respect the consumer's right to select a medical doctor or a podiatrist to furnish the needed care.

Since ERISA was enacted, however, insurance carriers in many states have successfully circumvented these statutes by invoking ERISA's preemption clause. The result has been to place chiropractic, podiatric, optometric, and psychological services outside the range of options available to beneficiaries.

This is a manipulation of the preemption clause that was clearly not intended by ERISA's drafters. It puts the Congress in the anomalous position of sanctioning efforts to narrow the range of choices available to consumers - and we are narrowing those choices in states that have taken direct efforts to broaden them.

The problem that has arisen as a result of this practice is not widespread - yet. Health care practitioners from my state of Texas have already been affected, as have practitioners in as many as 10 other states. And the problem will spread as insurance carriers begin to fully understand the "potential" that ERISA's preemption clause provides them.

During consideration of ERISA legislation in the 96th Congress, I was able to focus attention on this situation with the assistance of former Member of Congress Frank Thompson, who was the Chairman of the House Education and Labor Committee. In a statement on the floor of the House during consideration of the multiemployer legislation, Congressman Thompson acknowledged the problem and stated that it was not the intention of ERISA's drafters to allow the preemption clause to supercede state statutes in a way that limited the range of services available to health care beneficiaries.

As important as that statement was, it did not carry the force of law. Cases of non-reimbursement have occurred since Congressman Thompson spoke out. A clear-cut statement of principle is required; it must appear in legislation and it must be accompanied by clarifying language from a committee report. And that language must address the totality of the problem. Half-way measures will be used by some insurance carriers to escape their obligations under state laws.

Unfortunately, Mr. Chairman, the language in S. 1541 which seeks to resolve this problem will not suffice. It will allow insurance carriers to continue to hide behind the facade of preemption protection. Under this language, third-party carriers will be returned to the fold of state-controlled activities - at least where freedom of choice is concerned. But that language will not affect self-insured carriers and that is where the majority of the problems now exist.

As an alternative, I am proposing the following substitute to Section 3605(ii)(I) of S. 1541:

> "A provision of state law that defines which of the health professions may perform what services, and under which circumstances a person may obtain covered benefits from a provider licensed or certified by a state to perform a health care service, is not preempted."

I am also proposing that the accompanying committee report language clarify this section in this way:

> "The language added as Section 514(b)(2)(B)(iii)(II) (29 U.S.C. 1144 (b)(2)(B)(iii)(II)) is designed to clarify a point which was not contemplated at the time of the original enactment of ERISA. It affirms that the states'authority to determine the scope of practice of the health professions, and partic-

> ularly to assure that the public shall have access in the marketplace to all professions licensed to provide a particular service (such as through freedom of choice statutes) is not restricted by ERISA. State action in this area is in keeping with the intent of ERISA to protect the security and availability of benefits to persons covered by employee benefit plans."

Mr. Chairman, understanding the anxiety among many of ERISA's drafters when the subject of preemption is raised, I continue to believe that this problem can be corrected without sacrificing the intrinsic strength of the preemption clause. If S. 1541 cannot be amended with language resembling what I have proposed here, perhaps an alternative can be found that would preempt those state laws that detract from a beneficiary's rights under a health care plan, but not those laws which require broader protection than the Federal law requires. If an approach along these lines is required to ensure the integrity of ERISA, I would be more than willing to pursue it.

Above all, Mr. Chairman, I ask that we not lose sight of the need to protect - and not expose - a consumer's right of access to certain health care services. I look forward to working with you or your staff in the near future in arriving at a solution to this problem that is acceptable to everyone.

Again, thank you for this chance to express my views on this very important piece of legislation.

STATEMENT OF
TEAMSTERS FOR A DEMOCRATIC UNION
BEFORE THE
SENATE LABOR SUBCOMMITTEE
WASHINGTON, D.C.
NOVEMBER 30, 1981

Teamsters for a Democratic Union has reviewed the Retirement Income Incentives and Administrative Simplification Act of 1981 (S. 1541; H.R. 4330) and offers the following comments.

Teamsters for a Democratic Union (TDU) is a nationwide organization struggling to reform the Teamsters union and make it more responsive to the needs of the members. Today, TDU has a membership exceeding 8,000, organized into nearly 50 chapters across the country. We reach approximately 60,000 Teamsters monthly through our newspaper, Convoy Dispatch.

Pension fund issues have always been a part of TDU's focus. The TDU staff has prepared several publications on Teamster Pension funds and their mismanagement. TDU members have testified before numerous subcommittees on Teamster pensions and pending pension legislation. Members have initiated lawsuits against corrupt and arbitrary policies which exist in many Teamster Plans.

Since its introduction in Congress on July 30, 1981, the Retirement Income Incentives and Administrative Simplification Act of 1981 has been touted by its proponents as an attempt -in 300 pages- to simplify the whole pension process and thereby to a) provide for more effective and efficient administration of private pension plans, b) encourage greater investment by individuals in retirement plans, and c) stimulate the establishment of new plans.

The bill purports to be a response to a flood of regulations, organizational waste and inefficiency that is causing chaos and adversely affecting the interests of plan participants.

The stated aims of the proposed legislation are laudatory. There is no question that the current Act and administrative enforcement of it have some shortcomings. Instead of presenting remedies, however, the proposed legislation contains many provisions which would jeopardize pension funds by:

- relaxing the reporting and disclosure requirements;
- easing rules which concern the assignment and allocation of fiduciary obligations;
- Loosening the rules which restrict how pension assets may be invested.

Teamster Pension Fund abuses and mismanagement arose years before the enactment of ERISA. Not until ERISA reporting and disclosure requirements were implemented, however, could Teamster members discover the mechanics of their pension funds. Disclosure has enabled Teamsters to uncover innumerable pension irregularities. In spite of this, the proposed legislation would:

- eliminate the furnishing of summary annual financial reports to participants and beneficiaries (Section 3207);
- extend the time between updates of summary plan descriptions from five to ten years (Section 3206);
- eliminate the current requirement to submit information on important financial transactions to the Department of Labor (Section 3211);

- Deny participants clear statements about the size of benefits they can expect (Section 3209);
- Allow plans with less than 100 active participants to file a simplified annual report (Section 3205).

Rank and file Teamsters who have testified before the Select Committee on Aging and the Permanent Subcommittee on Investigations are requesting that they be given access to more, not less, information. Any new legislation should reflect these concerns.

Other areas of the proposed legislation also cause particular concern to TDU members. Section 3308 denys pension credit to workers whose employers are delinquent in making contributions to collectively-bargained multiemployer plans. This takes away the multiemployer plan's incentive to collect the delinquencies. "Sweetheart" deals are commonplace in the Teamsters union. Section 3308 exacerbates this situation and is an invitation to abuse.

Sections 3301 and 3311 would increase the years required to vest in a pension. The current 10 year cliff vesting is already far too long.

Section 4811 would change rules governing the interaction between private pension benefits and Social Security to make it more likely that lower income workers will get no pension from their plans.

Section 3302 would allow multiemployer plans to take away pension benefits from a pensioner who returned to any trade or craft in which he had previously worked. It fails to consider those retirees who must return to work to supplement their inflation-eroded pensions.

Pension plans were created to provide for worker security during retirement years when financial survival is toughest. The enactment of ERISA to protect plan participants and beneficiaries was necessitated by pension fund abuses. Despite prouncements to the contrary, the thrust of the proposed legislation is antiparticipant insofar as it would weaken many of the hard won pension fund protections. As documented by the Senate Permanent Subcommittee on Investigations, pension fund abuses in the Teamsters union are rampant; to the extent that S.1541 and H.R.4330 countenance further abuses, this legislation is opposed.

Teamsters For A Democratic Union
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American Society for Personnel Administration

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NOV 30 1981

November 30, 1981

The Honorable Don Nickles, Chairman
Subcommittee on Labor
Committee on Labor and Human Resources
United States Senate
Washington, DC 20510

Dear Senator Nickles:

Enclosed is our statement concerning S. 1541, the Retirement Income Incentives and Administrative Simplification Act of 1981.

ASPA is pleased to have had your encouragement to comment on this proposed legislation and stands ready to be of assistance on this and other labor issues should the opportunity arise.

Yours very truly,

James H. Ferguson
Vice President, Government Affairs

Enclosure

JHF/cd

National Headquarters 30 Park Drive Berea, Ohio 44017 Telephone (216) 826-4790

American Society for Personnel Administration

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STATEMENT OF
THE AMERICAN SOCIETY FOR PERSONNEL ADMINISTRATION
TO THE
UNITED STATES SENATE SUBCOMMITTEE ON LABOR OF THE COMMITTEE ON LABOR AND HUMAN RESOURCES
REGARDING
S. 1541 - RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE SIMPLIFICATION ACT OF 1981

November 25, 1981

The American Society for Personnel Administration is the world's largest professional organization of personnel and industrial relations practitioners in business, industry, government and education. It has 30,000 members and 330 chapters in all 50 states and 29 foreign countries. ASPA's members represent organizations which employ about 27,000,000 people.

Since the early 1970s ASPA, has evaluated numerous proposed bills concerning pension and other benefit legislation and presented testimony to many congressional committees.

It is rewarding to observe the proposed legislation in S. 1541 that will correct many of the deficiencies of ERISA that have created costly administrative burdens on plan sponsors without really enhancing the delivery and security of pension benefits to employees.

In the interest of brevity, this testimony will be confined to statements of support or opposition with respect to the key provisions, and succinct explanatory statements as appropriate.

National Headquarters 30 Park Drive Berea, Ohio 44017 Telephone (216) 826-4790

S. 1541

Title I

ASPA can support the single agency concept as simplifying the entire process of interaction between plan sponsors, participants and the government. The proposed legislation should further specify that the EBA organize administration in a fashion that plan sponsors will need to interact with only one office to transact business. If business must continue to be conducted with several sub-agencies of the EBA there is doubt that much improvement will occur.

Title II

ASPA supports the deductibility of mandatory contributions, simplification of the limits by removing the 15% limitation, and deferral to age 75 of the commencement of withdrawals.

We question, however, the complexity of this title with alternative deductions, special rules and the excluded Social Security tax. Why can't it simply provide that between mandatory contributions and voluntary contributions the deduction cannot exceed the limit? It doesn't have to be made so complex that it perpetuates confusion and administrative burdens.

Section 3101: We applaud the description of severance pay plans as welfare plans. These are useful and important benefits that deserve encouragement and supportive legislation.

Section 3205: We support the simplified annual report for small employers but question the 100 active participant break point. The number could be 500 without damaging participant interests in any manner and would save small employers millions of dollars.

Section 3206: We support less frequent required distribution of SPD's.

Section 3207/3208: The SAR's and Notice to Interested Parties are totally useless communications. We propose they be eliminated entirely for a five year period and be reinstituted only if there is evidence that participants' interests have been damaged by their removal. They are a costly, and unnecessary administrative burden on plan sponsors and only confuse participants.

Section 3310: While this section is helpful, it is still not clear that a plan sponsor can comply with a required distribution under community property laws in many states without becoming entangled in ERISA non-assignment provisions. S. 1541 should clarify this issue, clearly permitting such legally required distributions in community property states. Employers in such states as California continue to be plagued by this lose-lose circumstance.

Title IV

Section 4811: Integration of private benefits and Social Security is the key interaction between these two legs of the triad that provide total retirement income. It should be strengthened as a practice and the incredibly complex present rules simplified. It appears that this section attempts to achieve those purposes. However, it is not clear what the purpose is of the minimum combined roles of Section B (III) (iv) and the maximum rules of (C) (ii).

If the intent is to establish a minimum benefit and a maximum benefit for integrated plans, we would be very concerned about this provision.

In its ideal and simplest form, the integration rules should allow for plans that specify in a straightforward manner that benefits from Social Security and a private plan may be combined to provide a certain percentage of covered salary for all participants.

While we support the concept of integration and its simplification, this section requires clarification in its intent and purpose.

Title V

We totally oppose any mandatory requirement for employers to establish payroll deductions for employer contributions to IRAs. Employees can easily secure an IRA if they wish and IRAs are also available by payroll deduction in credit unions of many companies. Several studies subsequent to ERTA have shown that the administrative burden placed on plan sponsors brings into serious question the utility of employer offered IRAs when they are so easily available elsewhere with administrative systems already in place.

Mandatory employer sponsorship of IRAs is a serious mistake.

Conclusion:

S. 1541 is, in total, a good bill and we can support much of it. We ask serious review of Titles IV and V and will be glad to add further information for the committee's consideration.

We are especially pleased about Section 3605 which will clearly preempt state law in benefit matters and thereby encourage benefit plan expansion and save millions in confusion, paperwork and litigation over this issue.

We in ASPA stand ready to work with the Congress toward improving pension plan administration.

Statement on S. 1541
before
Committee on Labor & Human Resources
United States Senate
on behalf of
International Union, United Automobile, Aerospace and
Agricultural Implement Workers of America, UAW 1/

November 30, 1981

The UAW opposes the enactment of S. 1541,* the proposed "Retirement Income Incentives and Administrative Simplification Act of 1981," because of its unnecessary omnibus scope, and because many of its specific provisions would be detrimental to the interests of plan participants.

This bill mixes provisions for substantive changes with others which would freeze into legislated inflexibility matters that are now handled by administrative rulings. In many cases, the proposals would not change the current administrative practice, but - equally important - they would inhibit any change which may prove to be needed in the future. The interaction of ERISA (Employee Retirement Income Security Act) with the vast array of private retirement income programs has proven - not unexpectedly - to be exceedingly complex, and has benefited from the ability to adapt ERISA's general principles to the variety of issues presented by specific circumstances. In light of the scope of issues involved (which is perhaps epitomized by this almost 300 page bill, to amend a law that took more than 10 years to enact), and the dynamics of pension plan design, it is understandable that seven years after its

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1/ Prepared by Howard Young, Director, UAW Social Security Department.

* The companion bill is H.R. 4330.

enactment the ERISA administrators continue to be learning new techniques. It is not necessary, and - in fact - would be undesirable, to impose legislative restraints on those techniques; rather, they should continue to be improved on the basis of ongoing experience.

Although that objection to the bill should be sufficient reason to send it back to the legislative drafting room for major surgery, there is even greater concern about the substantive changes which would harm plan participants.

The UAW pays particular attention to ERISA, especially its provisions regarding PBGC (Pension Benefit Guaranty Corporation), since we were the original advocates - in the early 1960s - of many of the employee protections involved. We do not contend that the present legislation is perfect from the point of view of plan participants and the unions who represent them, employers or other sponsors, or the government. However, the protections provided - whether an ongoing or terminated plan is involved - are tremendously beneficial, and generally function well.

Instead of improving upon and expanding those protections, S. 1541 would reduce them in various ways or would institute procedures that most likely would result in such reductions. As a single example, Section 6104 would provide that subsequent Congressional inaction could produce lower benefit guarantees in the event of plan termination; that is, simply obstructing a Congressional vote on the matter in either the House or the Senate, it would be possible for opponents of the PBGC to reduce the protective levels then in effect, rather than to collect the premiums for that protection.

Even where the bill deals with the valid concern about possible employer abuse of the PBGC program, it falls short of developing a satisfactory alternative. Unfortunately, UAW members have been the target of several employer proposals to terminate existing pension plans and rely upon PBGC guarantees. We have resisted such proposals, but in some cases lost out to the economic pressures applied by the employers. In those situations, we have not intervened in any subsequent dispute between PBGC and the employer, even when - for example in the Facet case - there are unique circumstances involved.

Based on the experience so far, it is not clear that any legislative change is needed to protect PBGC from the feared employer abuses. Nevertheless, we are prepared to join in efforts to clarify the situation for future plan terminations, provided that does not reduce the protections available to workers whose plans are validly terminated; in fact, there are various improvements which should be made in workers' protection.

S 1541 demonstrates the difficulties involved. ERISA, and PBGC, involve many highly controversial matters. The current legislation reflects compromises hammered out in many years of legislative debate - involving several committees as well as floor debate on the House and Senate - which had been preceded by years of debate and discussion in other public policy forums. The 1974 Act has been, on the whole, quite successful; undoubtedly it can be improved in various ways, but S. 1541 would not do that. Instead, it proposes objectionable and unnecessary changes, and we oppose its enactment.

We urge the committee to allow further study and administrative adaptation under the existing law, before moving forward with any comprehensive proposal.

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AAP ASSOCIATION for the ADVANCEMENT of PSYCHOLOGY

Statement by

Clarence J. Martin

on behalf of

The American Psychological Association

and

The Association for the Advencement of Psychology

before the

Subcommittee on Labor

of the

Senate Committee on Labor and Human Resources

on the subject of

The Employee Retirement Income Security Act

November 30, 1981

1200 Seventeenth Street, N.W., Washington, D.C. 20036 • Phone (202) 466-5757

Mr. Chairman, members of the subcommittee, this testimony is submitted on behalf of the 35,000 psychologists who provide health services, and the 15 million consumers of health services whom they serve.

The Employee Retirement Income Security Act (ERISA) is being used to nullify state laws in areas where no substitutable or comparable federal laws exist, creating a situation which subordinates state legislative perrogatives to the judgment of insurance carriers immune from any public review or redress.

Since the passage of ERISA in 1974, a series of court cases have arisen which provide confusing and conflicting interpretations of the Act. I am addressing only one of the several litigious aspects of the program; that is, the contradictory holdings by both state and federal courts over the interpretation of 29 USC 1144 (Sec. 514 of the Act) which is generally referred to as the preemption clause.

Preemption is a misnomer. Our concern is not with a conflict between a substantive state law and a substitutable federal law, but the nullification of state law where no comparable federal provisions exist. Through this nullification/preemption of state law, insurance plans can substitute whatever rules they deem proper -- rules that are formulated by the insurance carriers without public hearings, without debate, without appeal or other public redress. These rules regulating the health, safety and welfare of citizens are not formulated by duly elected representatives but by insurance company employees.

A total of forty-six states and the District of Columbia have statutes which contain some kind of "freedom-of-choice" clause for health insurance. These laws require insurance carriers to reimburse either the beneficiary or practitioner for covered services that any of a number of practitioners may (by state credentialing laws) deliver. These statutes relate to the services of psychologists, psychiatrists, podiatrists, optometrists and chiropracters, to name a few.

My remarks are limited to state laws which affect the services of psychologists who are licensed to provide health care in 50 states and the District of Columbia.

It has become a common practice for health insurance programs which qualify as ERISA programs to place these duly licensed practitioners outside the access of beneficiaries by invoking ERISA's preemption clause.

Thirty-one states and the District of Columbia have enacted freedom-of-choice laws which mandate that psychologists must be reimbursed under insurance contracts for services in the contract that psychologists are licensed to render.

These states are:

Arkansas
California
Colorado
Connecticut
District of Columbia
Georgia
Hawaii
Illinois
Kansas
Louisiana
Maine
Maryland
Massachusetts
Michigan
Minnesota
Missouri
Mississippi
Montana
Nebraska
Nevada
New Mexico
New York
North Carolina
Ohio
Oklahoma
Oregon
Pennsylvania
Tennessee
Texas
Utah
Virginia
Washington

Sec. 1144 of ERISA has been used to nullify the intent of the state legislatures of these states and substitute for these statutes a rule formulated by the insurance carriers that only physicians (any physician: gynecologist, pediatrician, urologist, etc.) can be reimbursed for mental health services.

During the consideration of ERISA legislation in the 96th Congress, it was clearly stated that the intention of Congress was not to limit access to providers. Mr. Thompson (D-NJ), speaking as the floor manager of the ERISA bill, said,

> "Finally the distinguished gentleman from Texas, Representative Frost has asked me to clarify the effect of ERISA's preemption provision on a state law requiring that health insurance contracts written in that state must provide covered persons the option to choose the specialist of their choice or must provide that the services of a particular specialist must be covered by the insurance contract if that patient chooses to go to that specialist. It is clear that ERISA does not preempt such a law,..." (Congressional Record August 26, 1980, p. H7902)

As important as that statement was, it did not carry the force of law. Cases of non-reimbursement have occurred since then. Indeed, they are reported to the various professional associations nearly every day.

What is needed is a clear and unequivocal statement of principle; it must appear in the legislation and it must be accompanied by clarifying language in the committee report. Any ambiguity may be used by some insurance carriers to escape their obligations under state law.

Unfortunately, Mr. Chairman, the language in S. 1541 which seeks to resolve this problem will not suffice. It will allow insurance carriers to continue to nullify state law behind the facade of preemption protection. The language presently contained in S. 1541, p.146, lines 6-14, would reinstate state-control over third-party carriers but will not affect self-insured carriers. That is where the majority of the problems exist.

I would like to propose the following substitute to Sec. 3605(b)(2)(B)(iii)(II) of S. 1541;

> "A provision of state law that defines which of the health professions may perform what services, and under which circumstances a person may obtain covered benefits from a provider licensed or certified by a state to perform a health care service, is not preempted."

Furthermore the meaning of this language should be made unequivocal by committee report language such as:

> "The amendment to Sec, 514(b)(2)(B)(iii)(II), (29 USC 1144 (b)(2)(B)(iii)(II)) is designed to clarify a misinterpretation of the Congressional intent of the ERISA law. The amendment affirms that the states' authority to determine the scope and practice of the health professions, and particularly to assume that the public shall have access in the marketplace to all professionals licensed to provide a particular service (such as freedom-of-choice statutes) is not restricted by ERISA."

I believe, Mr. Chairman, that the language I propose would restore to the states their undisputed right to regulate the practice of health professionals in their jurisdictions, would restore to ERISA beneficiaries their freedom of choice of health care providers and would divest the insurance carriers of the power they have usurped from the state under the ERISA preemption clause.

There is a second clause of S. 1541 which especially concerns providers of mental health services. The recent dramatic confrontation between federal employees and the U.S. Office of Personnel Management has highlighted a historical discriminatory policy by some insurance carriers against the coverage of mental and emotional disabilities. This discrimination has been declining. A recent survey by the Washington Business Group on Health showed that 80% of the employer health insurance contracts surveyed provided for treatment for alcohol, drug abuse and mental health needs.

State by state, laws have been passed to compensate for inequities in the health insurance market.

State by state, laws have been passed in recognition that the market forces in health insurance are not purely economic, but often bow to other interests.

It is our concern that the provisions of S. 1541, Sec.3605(b)(2)(B)(ii)(I) would encourage the exclusion of mental health benefits from policies of insurance issued under ERISA.

Twenty-two states now have laws which require either a mandated minimum mental health package, which explicitly defines the minimum mental health benefits that an insurer must include in a group or individual policy, or which mandate that insurance carriers offer mental health coverage. These mandated availability provisions stipulate that insurers must offer (or make available) a minimum set of mental health benefits to the subscriber, the actual purchase of which is left up to the discretion of the policy holder or group purchaser.

The 22 states are:

Arkansas
California
Colorado
Connecticut
Florida
Hawaii
Illinois
Kansas
Louisiana
Maryland
Massachusetts
Minnesota
New Hampshire
New York
North Dakota
Ohio
Oregon
Tennessee
Vermont
Virginia
West Virginia
Wisconsin

Other types of mandated coverage laws apply not only to benefits, but frequently to classes of individuals as well. Forty-nine states, for instance, have laws relative to the coverage of newborn children.

The reason for these mandated benefits is not casual but causal. State after state has recognized that the health care consumer must be offered a wide range of health benefits, an opportunity to periodically amend that coverage, and an opportunity to be educated as to the relative costs and benefits of their health insurance options.

The laws of the states which regulate these aspects of health insurance are the product of years of experience and should not be swept away by a plea of inconvenience by the insurance companies.

The purpose of Sec. 3605(b)(2)(B)(ii)(I) is allegedly to allow uniform insurance coverage in all states through one group policy. No rules or regulations exist defining what a uniform policy should or should not contain. If enacted as presently constituted, S. 1541 would allow contracts under ERISA to wipe out provisions for regulating insurance that have been established by a majority of states, such as coverage for newborn children.

This is clearly inappropriate and must be remedied.

There are no federal requirements in ERISA setting out what should or should not be included in an insurance policy. In the absence of a clear justification, a type of legislation traditionally occupied by the states should not be superseded.

Voiding state laws mandating basic benefits or coverage of certain classes without providing a federal substitute would put the content of ERISA insurance coverage beyond any governmental control and surrender an important police power to private industry.

I recommend that Sec. 3650(b)(2)(B)(ii)(I) of S. 1541 be abandoned. The only argument offered in its support is the convenience of the negotiation and administration of insurance by the carriers, and that is not a sufficient argument to overcome the right of the several states to regulate in the best interest of their citizens.

Thank you very much.

**AMERICAN
TRUCKING
ASSOCIATIONS, INC.**
1616 P Street, N.W., Washington, D. C. 20036

PRESIDENT
Bennett C. Whitlock, Jr.
(202) 797-5212

November 30, 1981

DEC 1 1981

The Honorable Don Nickles
Chairman
Subcommittee on Labor
Senate Committee on Labor and
  Human Resources
Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

The American Trucking Associations, Inc. (ATA) is the national trade association of the trucking industry. We speak for more than 18,000 firms regulated in interstate commerce as well as thousands of private fleets. Most of these trucking companies are small businesses; many are large. Many companies contribute to single employer as well as multiemployer pension plans.

You are probably well aware that the conscientious effort to make the multiemployer pension plan more secure by virtue of the Multiemployer Pension Plan Amendments Act of 1980 will undoubtedly result in the destruction of that type of plan. If the rash of constitutional attacks fails to revoke the Act, there will be no new multiemployer pension plans created. Those in existence will be phased out as quickly as possible.

The current thinking in the business community and, in some cases, their labor unions, is to adopt a money purchase plan or, better yet, pay the current cost of pensions directly to the employee and let him invest in an Individual Retirement Account (IRA). The result would be no liability, reports, trustee costs, etc. Extending multiemployer-type liabilities to single employer plans, as proposed in Title VI of the Retirement Income Incentives and Administrative Simplification Act of 1981 (S. 1541), will affect single employer plans in the same manner that the Multiemployer Act affected multiemployer plans.

Accordingly, ATA strongly is opposed to the passage of Title VI of S. 1541. Our complete statement is enclosed. We request that it be included in the present hearing record of S. 1541.

Sincerely,

Bennett C. Whitlock, Jr.

cc: Members of the Subcommittee on Labor

Subcommittee on Labor
Senate Committee on Labor and Human Resources
S.1541

The American Trucking Associations, Inc. (ATA) is the national trade association of the trucking industry, a federation of associations in all 50 states and the District of Columbia. We speak for more than 18,000 firms regulated in interstate commerce, as well as thousands of private fleets. Most of these trucking companies are small businesses; many are large. Many of these members have single employer pension plans as well as multiemployer plans. Therefore, ATA is very much interested in the "Retirement Income Incentives and Administrative Simplification Act of 1981" (S.1541).

ATA's primary interest in S.1541 concerns Title VI - Amendments Relating to Single Employer Plans. For reasons which will be set forth subsequently, ATA strongly opposes Title VI. Briefly, however, ATA will address Titles I through V.

There are many excellent provisions in S.1541. For example, the vast majority of changes contained in Titles III and IV are favorable. With respect to Title I, which provides for the consolidation of the government's employee benefits function into a single agency called the Employee Benefits Administration, the decision on how to organize itself appropriately remains with the government. Title II may be unnecessary because the Economic Recovery Tax Act of 1981, enacted after the introduction of S.1541, contains provisions very similar to Title II.

Finally, with certain limitations relating to employee size and a referendum rule, Title V would require all employers to establish payroll deduction programs allowing employees not covered by pension plans to designate amounts to be contributed to Individual Retirement Accounts. In light of the tremendous competition among all financial institutions to provide IRAs to all employees, pensioned or unpensioned, beginning on January 1, 1982, the mandatory requirement contained in this Title appears unnecessary.

ATA's primary concern in S.1541 is with Title VI. ATA's position on this Title is predicated upon its experience with the Multiemployer Pension Plan Amendments Act of 1981, which, briefly put, has been more than catastrophic. The Multiemployer Act was enacted on September 26, 1980. The primary concept of this Act is the requirement that an employer who wholly or partially withdraws from a plan pay his pro-rata share of unfunded vested liability (known as withdrawal liability) to the plan. Shortly before enactment of the Multiemployer Act, Congress passed the Motor Carrier Act of 1980 on July 1, 1980. One of the primary effects of the Motor Carrier Act was to increase competition; one of the products of which is that a number of employers are being forced out of business. Therefore, by these two actions, Congress not only forced a number of employers out of business, but also took the employer's money as he was forced out of business.

Moreover, it is important to recognize that the liabilities created by the Multiemployer Act are very substantial. For example, Johnson Motor Line's withdrawal liability to the Central States Pension Plan alone is $16,658,936.94. This greatly exceeds Johnson's net worth of $6,821,714. Transport Motor Express' (TMX) withdrawal liability of over $8,000,000 exceeds by about $4.4 million the $3.6 million remaining from the liquidation of TMX.

There is a broader chronological perspective to the multiemployer problem which has an important bearing on Title VI of S.1541. Since the mid-1950's unionized employers only negotiated contributions in their collective bargaining. The promise of a benefit was never made in the bargaining agreement, and the employers' liability was limited to their contributions.

This was the extent of the employer's liability until 1974. Then, in the Employee Retirement Income Security Act of 1974 (ERISA), Congress redefined multiemployer plans as defined benefit plans. This increased the liability to 30% of the employer's net worth in the event of plan termination. No liability was imposed for employer withdrawal from the plan.

In the Multiemployer Act of 1980, Congress increased the employer's liability to the full value of unfunded guaranteed benefits either in the event of an employer's withdrawal from the plan or the plan's termination. This result revoked the pension plan provisions of thousands of collective bargaining agreements and imposed upon the employer a much greater liability than both he and the union agreed to in their contracts.

A number of practical problems have emerged because of the Multiemployer Act. First, the Act disrupts normal business practices. Because the employers' withdrawal liability is so large -- in some cases over $13,000 per employee -- it effectively prevents unionized companies from going out of business or relocating. Obviously, a liability of this magnitude also prevents the sale of a company's assets.

Second, the Multiemployer Act restricts company growth. To the extent unionized companies continue normal business practices, they will accumulate partial liabilities by acquisition, sale of assets, or relocation of facilities. In addition, the Financial Accounting Standards Board likely will require union employers to footnote their potential pension liability on their financial statements. This can drastically reduce the ability of the company to borrow money.

Third, the Multiemployer Act will damage multiemployer pension plans. Obviously, to the extent the contributing companies are endangered financially, the plans themselves are endangered. Moreover, the imposition of withdrawal liability will damage multiemployer plans because the huge potential liability will discourage new employers from entering the plan. Without the normal replacement of employers and participants, multiemployer plans will face decline and insolvency. Lastly, the multiemployer pension plans are not collecting withdrawal liabilities in the trucking industry; only lawsuits have been filed.

Thus, both employers and multiemployer plans are being damaged by the Multiemployer Act. The industry is being crippled and is in vital need of relief. This is the context from which the trucking industry views Title VI of S.1541.

First in Title VI, as in the Multiemployer Act, the liability of a contributing sponsor would increase from 30 percent of his net worth to general creditor status. Second, the insurance would not be available upon termination of a plan but only upon a plan sponsor's insolvency. Third, the employer would be fully liable to the Pension Benefit Guaranty Corporation (PBGC) for the plan's guaranteed benefits. Fourth, this liability to the PBGC would be extended beyond the contributing sponsor so as to include each member of any control group in which the contributing sponsor was a member. The definition of control group is expanded by defining common control as 50 percent or more (present definition of "controlling interest" is 80 percent or more (see 26 CFR 11.414(c) - 2(b) (2) (A))). Liability is extended further to any employer who was a member of a control group in which the contributing sponsor was a member within the past five years or even 15 years if the control group is changed with "a purpose" of avoiding liability for plan benefits. In addition, liability following a change of a contributing sponsor attaches to the prior contributing sponsor and each employer who was a member of a control group in which the prior contributing sponsor was a member five years before the date of the change if the new contributing sponsor becomes insolvent anytime within 15 years after the date of the change in contributing sponsors.

The law would extend exceptions depending upon the net assets of the new contributing sponsor and control group, net assets of the prior contributing sponsor and control group, the unfunded vested liability of the plan and number of participants of the prior contributing sponsor and control group. Absent the application of these exceptions, liability theoretically could attach to any member of a prior contributing sponsor for the next 20 or 30 years. In an industry where there have been a lot of transactions -- at least prior to the passage of the Multiemployer Act, it is important to realize that even a small number of sales could result in liability attaching to hundreds of companies. This could paralyze purchases and sales in a significant portion of the industry.

There are legitimate problems which Title VI addresses, albeit in the wrong way. Some ongoing employers with a low net worth have recognized that they may be able to terminate their pension plans for a lower cost (30 percent of net worth) than the value of their unfunded liabilities. Other firms have spun off weak subsidiaries and their unfunded liabilities which removes the parent companies' assets from the PBGC's reach. Therefore, in certain circumstances, current law encourages employers to terminate their plans and avoid certain liabilities.

However, while this financial exit from unfunded liabilities exists, very few employers have opted to escape from their liabilities in such a manner. To hold every employer-member of a prior control group liable for financial responsibilities of the new contributing sponsor and control group for up to 20 or, in some cases, 30 years; to burden every future business transaction involving a sale with a requirement to develop additional data on net assets of the new contributing sponsor and control group, net assets of the prior contribution sponsor and control group, unfunded vested liabilities, number of participants of prior contributing sponsor, etc.; to increase liability to 100 percent of unfunded guaranteed benefits; and to expand the breadth of the control group is a classic example of overkill.

It is not necessary to attack all future transactions involving an employer who was generous enough to provide his employees with a defined benefit plan in order to close the exit on the handful of employers who have escaped from their liabilities. Instead, Congress should search for a cure more appropriate for the disease. Some possible solutions include:

1. Prohibit any employer, regardless of size, who has terminated a pension plan and dumped an unfunded liability for guaranteed benefits on the PBGC from establishing any new tax-favored program or amending any existing program to increase benefits

or coverage for a period up to seven years after that termination. This would impose burdens only on those employers who are playing games with the plan termination program and will not impose contingent liabilities on every pension plan sponsor who sells his business.

2. Increase the PBGC premium.

   The present premium of $2.60 per man per year is less than one one-thousandth of what a trucking company annually pays into a typical multiemployer plan for each employee. A recurring expense which is fairly stable in amount is far preferable to exposing the business of every pension plan sponsor to the haphazard and capricious imposition of liabilities in the millions.

For all the reasons set forth above, ATA is convinced that Title VI of S.1541 is not the most appropriate answer to the problem this Title addresses. If adopted, Title VI can lead to many of the same problems for the employer with a single employer plan that are now being experienced by the employer who contributes to a multiemployer plan. For example, Title VI effectively would take away the right of an employer to sell his business without incurring a contingent liability for 15 years. Thus, in its present form, ATA strongly opposes Title VI.

Instead, ATA favors removing or changing Title VI in accordance with the above recommendations for all employers regardless of size. Short of this, ATA would favor the creation of a Study Commission to hold public hearings and to accept the views of all parties affected in order to find an appropriate "cure". Quite frankly, ATA is concerned that if Congress passes Title VI, it will effectively shoot itself in the foot a second time on a Title IV ERISA problem. We appreciate the opportunity you have given us to address this important matter.

NATIONAL WOMAN'S PARTY

SEWALL-BELMONT HOUSE

144 Constitution Avenue, N. E., Washington, D. C. 20002 (202) LI 6-1210

November 9, 1981

Senator Don Nickles
Chair, Senate Labor and Human Resources
Subcommittee on Labor
4230 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Senator Nickles:

The National Woman's Party has had as its goal the objective of equality for women under the law since this organization was founded by Alice Paul in 1913. The National Woman's Party recognizes that many women do not now realize the pension privileges that men enjoy, and we support all efforts to rectify such inequalities and inequities suffered by women.

The National Woman's Party recognizes that women are the innocent victims of pension plans that do not include joint and survivor annuity requirements. This organization is particularly dismayed to learn that your proposed legislation falls short of remedying the inadequacies of the private pension sector's coverage for retired workers and their families. The pension needs of women are decreased, rather than enhanced by your amendments to ERISA (S. 1541).

Therefore, we urge that the Subcommittee consider the provisions of H.R. 1641 (Ferraro, D-N.Y.) and S.888 (Hatfield, R-Or.) and either include them as amendments or provisions in the proposed Nickles bill or consider them separately.

Sincerely,

Elizabeth L. Chittick

Elizabeth L. Chittick
President

ELC:sfg

Board of Global Ministries
The United Methodist Church
475 Riverside Drive, New York, N.Y. 10027. (212) 678-6161.
Cable: missions new york

November 9, 1981

The Honorable Don Nickles, Chair
Senate Labor & Human Resources Subcommittee on Labor
4230 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Nickles:

The Women's Division of the United Methodist Church is vitally interested in the provisions for amending ERISA (S.1541) which are being considered by your subcommittee.

Our concern arises not only from our long commitment to equity and justice in the treatment of women in our society but from the fact that 78% of our over one million members are over 45 years of age.

In April of 1981 the Board of Directors of the Women's Division passed a resolution on Economic Justice for Women: Retirement Income. The resolution said in part that we would support private as well as public pension plan reform which would:

- * provide for earlier vesting
- * provide for mandatory survivor's benefits for widowed spouses and for divorced spouses on a pro-rata basis
- * support the concept of pensions as part of joint property to be divided in case of divorce

This resolution leads us to the following comments on S. 1541:

1. Allowing equivalent death benefits as a substitute for survivor's benefits seems to us to be not only an inadequate but risky provision for any pension plan. What women need is a sure monthly income for all their lives, not one subject to the vagaries of the investment market or to the uncertainties of handling a large sum of money which must meet needs for an indeterminate amount of time.
2. The provision which allows survivor's benefits to be assigned to another designee, with approval of the current spouse, will not be effective in providing for ex-spouses, in our view. It is hard to imagine what would motivate a current spouse to agree to the assignment of survivor's benefits to the former spouse. Further, this provision could prove more costly. For example, a designee could be a child who would have a considerably longer life span than an ex-spouse.

Women's Division, 15th floor

3. Our resolution also contained support for pension reform which would:

   * follow the recommendations of the President's Commission for Pension Policy for a Minimum Universal Pension System.

   Consideration of the Commission's recommendations may not be practical at this point, due to the prevalent "belt-tightening" concerns. But it would go a long way toward eliminating the inequities women face in the pension area. These inequities are caused by comparatively shorter job tenure, which prevents vesting, and by the high percentage of women employed in low paying jobs which have no pension program.

We would hope that every avenue would be explored to prevent the elderly poor, the preponderance of whom are women, from either miserable, shortened lives or dependence on the taxpayer through welfare systems.

For these reasons we support the testimony being given by the National Women's Political Caucus. Further, we affirm our preference for S.888 (Hatfield, R. Or.) and H.R. 1641 (Ferraro, D. N.Y.) because of the practical manner in which they address the problems of women in the pension field.

Sincerely,

Joyce V. Hamlin

Joyce V. Hamlin
Secretary for Legislative Affairs

jvh:cml

THE WASHINGTON POST
Editorial
July 11, 1980

Docscam

ONE OF THE WAYS in which the federal government encourages saving for retirement income is by granting significant tax advantages to employers who finance pension plans for their employees. A criterion for qualifying for tax exemption is that the plan distribute benefits fairly—that there be no spectacular discrepancy between the treatment of officers of the corporation, for example, and rank-and-file workers. If a corporation were to fire employees to keep them from becoming qualified for benefits, the plan would lose its qualification and the employer's contributions would be subject to taxation. This has been the law since 1942.

Recently, a squall has blown up in this area, because a number of employers believed that a 1974 change in the pension statutes allowed them to avoid ever being subject to an investigation of how their plan operated if they adopted a standard known as "4-40 vesting." This procedure establishes that an employee attains a permanent right to receive 40 percent of his benefits after four years of employment, with additional percentages with each year of employment until 100 percent of the benefits are permanently his after 11 years. But the IRS began to note that in a number of corporations, the turnover among relatively low-wage employees was high, while the officers of the corporation stayed forever. Professional corporations—doctors', lawyers' and dentists' offices—are the prime examples. Nurses, receptionists and hygienists come and go, while the doctor is the only constant in the office. Under some plans, the effect is to lower the amount the employer has to pay in—what he contributed for one receptionist who left after two years because her husband was transferred to Milwaukee would go to finance the benefits of all the rest. Under other forms, the accrued extra value, for all those employees who didn't stay long enough to qualify, goes to raise the benefits of those who do qualify—the doctor himself. Under either form, it makes no sense. Tax benefits for these plans were established to make pensions available to the working force at large, not to provide yet another tax shelter for the already considerable income of the professional employers.

So the IRS has published a proposed regulation restating its intent to examine how pension plans actually function under the "4-40" rule, rather than taking it on faith that everything is fine. Outrage at the indignity of this IRS insult has been expressed by the professionals in the form of extreme pressure on Congress to overturn the proposed regulation even before it is published in its final form. Several bills have been introduced in the House to amend the Internal Revenue Code to keep the IRS from snooping around to see what is happening. And the panic is so great that there is some thought being given to outlawing such behavior in the Treasury appropriations bill.

We think the professional corporations protest too much. Although many are in good faith providing for their employees as well as they can manage, a number appear to have found themselves a very good deal—at the expense of the rank-and-file workers who don't get benefits and of the taxpayers who are subsidizing the whole fandango. Enough.

WEAL
Women's Equity Action League

805 15th Street, N.W., Suite 822
Washington, D.C. 20005
202/638-1961

November 9, 1981

Senator Don Nickles
Chair, Senate Labor & Human Resources
Subcommittee on Labor
4230 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Nickles,

The Women's Equity Action League commends you for looking into the problems of private pensions and welcomes this opportunity to comment on your amendments to ERISA (S. 1541). We are saddened that your proposed legislation falls short of remedying the inadequacies of the private pension sector's coverage for retired workers and their families and we are especially grieved that women's pension needs are decreased rather than enhanced by this bill. Women are the innocent victims of pension plans that do not include joint and survivor annuity requirements.

Section 3309 and 3310 of the bill contain six provisions which erode the protection originally set up by ERISA to ensure retirement protection for women.

The first section proposes a lump sum death benefit payment rather than the survivor annuity. This may result in lower administrative costs for the employer. It also may encourage many employers to drop benefits for life insurance if they assume that the lump sum will cover the survivor's needs. A lump sum benefit may be preferable to no benefit at all, but it would force the widow to become a skilled money manager. In the final analysis, there would be no guarantee that the amount would last her throughout her retirement lifetime. The very purpose of the survivor annuity requirement is to provide an on-going income for the survivor!

In the third section which provides that a participant may designate a person other than a current spouse as a survivor, it might be assumed that the participant would designate an ex-spouse as a beneficiary. Unfortunately, the wording of the clause would enable the participant to designate anyone as a beneficiary and the ex-spouse would most likely be the last considered. If the intent of amending this section is to consider the needs of the ex-spouse as an eligible beneficiary, better wording with clearer intent should be used.

In section four, WEAL does not agree with the provision regarding individual accounts that disallows the option for joint and survivor benefits and substitutes a defined contribution plan. A defined contribution plan usually pays death benefits in a lump sum and our previous apprehensions about lump sum benefits for widows applies here as well.

In section five, WEAL further disagrees with the provision that joint and survivors benefits are not required to be paid in disability situations when the disability occurs before the early retirement age, generally age 55. Joint and survivors benefits should be offered after any 10-year period of employment.

Section 3310 of the proposed amendment concerns the division of pension benefits in a divorce decree. The section, as drafted, results in a cumbersome, detailed provision which would require courts and divorce attorneys to be aware of specific requirements before a settlement is reached. The divorced spouse would be at the mercy of the court's and counselor's ignorance or enlightenment. This section should be simplified to follow the form of the Civil Service Statute (P.L. 95-366)

Section 4810 deals with "vesting" standards. Currently the Internal Revenue Code provides a special tax exemption for pension plans that do NOT favor highly paid employees. It is presumed that if private employers establish an employee's right to "vest" in pension benefits after 4 years of work, at a 40% level instead of the usual 10 years of work at a 100% level, the employer is remedying the pension discrimination for low-earning workers and therefore deserves a tax break. Sadly, the length of time on the job for women, especially in the kinds of employment areas that take advantage of this pension break, is under 4 years. Legal secretaries, dental assistants and the like rarely acquire pension credits even at the 40% level, much less the 100% level which requires 10 years of work. In order that women in these situations can receive some retirement benefits based on their work lives, the vesting schedules must be reconsidered and lowered. Enacting the 4/40 option into law effectively cuts of millions of women workers.

Section 4811 deals a harsh blow to women workers. WEAL opposes the concept of integration, which gives the employer the ability to "off-set" pension benefits with Social Security payments. The higher income individual who receives a proportionately lower Social Security benefit receives a higher share of their pension. The lower income individual receives a proportionately higher Social Security benefit and thus a lower share of their pension. Sadly, the lower income workers (predominantly women) suffer from this offset, often receiving little or no pension at all. Years of work accumulating pension benefits are lost and the worker rarely knows about this provision.

WEAL heartily supports the testimony presented to you today by Kathy Wilson, the National Chair of the National Women's Political Caucus. We insist that the Subcommittee recognize the pension inequities that women face in the private sector. We urge the Subcommittee to consider the provisions of H.R. 1641 (Ferraro, D-NY) and S. 888 (Hatfield, R-OR) and either include them as amendments or provisions in the proposed Nickles bill or consider them separately. As it now stands, S. 1541 simplifies procedures and provides incentives only to private employers and drastically reduces the chances for women workers to provide for their retirement years. WEAL cannot support S. 1541 as it stands.

Sincerely,

Carol Burroughs Grossman

Carol Burroughs Grossman
National President

THE
NATIONAL
FEDERATION
OF
BUSINESS AND PROFESSIONAL WOMEN'S CLUBS, INC.
of the United States of America

2012 MASSACHUSETTS AVENUE, N. W.
WASHINGTON, D. C., 20036
293-1100

November 9, 1981

The Honorable Don Nickles
Chair, Subcommittee on Labor
Senate Committee on Labor and Human Resources
4230 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Nickles:

The National Federation of Business and Professional Women's Clubs, Inc. of the United States of America (BPW) has been on record in support of pension reform to provide equity and adequacy for women for many years. BPW also firmly supports increased protection of the pension rights of spouses of employed persons and military personnel.

BPW is concerned that some of the provisions of S. 1541, the Retirement Income Incentives and Administrative Simplification Act of 1981 may have a negative impact on women. While we support the intent of S. 1541 to simplify procedures under ERISA and provide incentives to employers, we firmly believe that attention must be focused on eliminating the pension inequities which women now face. BPW is on record in support of S. 888, the Economic Equity Act of 1981. We urge the Subcommittee's attention to the pension reform provisions in that bill. We believe that these provisions, if adopted, would make the private pension system more responsive to the needs and work patterns of American women. S. 888 includes provisions to: lower the minimum age of participation in private pension plans from 25 to 21; allow company-approved maternity or paternity leave to count toward vesting and participation accrual; require the written consent of both spouses to waive survivor benefits; require payment of survivor benefits if the participant is vested but dies before retiring; eliminate the two-year waiting period for payment of survivor benefits for individuals who die from non-accidental causes; and establish pensions as a legitimate property right of marriage, which become divisible upon divorce.

We believe that these types of changes are needed because most women never receive any pension benefits from their employment. Today, almost half of the American labor force is female, but few women qualify for pension coverage. The latest Census data indicates that only one-fifth of all women workers are covered by a pension plan, as compared to half of all male workers. Currently, only 13 percent of women who work are receiving any earned pension benefits.

The reasons for these pension inequities are myriad. Women are clustered in occupations where there are few pension plans. Women workers are likely to leave paid employment for periods of time in order to raise children and fulfill traditional family responsibilities. The time that women take off for child-bearing often means that they do not stay at one job long enough to become vested in a pension plan. In addition, such "breaks in service" can limit the total pension credits a woman earns and even cause her to forfeit all previously earned credits. Women with children are more likely to work part-time or part-year and therefore may not be able to meet ERISA standards for a "year of service." Finally, current participation requirements under ERISA do not require employers to cover employees under 25 years of age. Yet, the age group with the highest labor force participation for women is from 20-24 years of age.

Because so few women will be entitled to an adequate pension benefit in their own right, it is crucial that the rights of surviving spouses to pension protection not be diminished. BPW is concerned with a provision in section 3309 of S. 1541 relating to joint and survivor benefits. This provision would allow defined benefit and defined contribution plans to substitute a death benefit, a lump sum payment, in place of a survivor annuity. There are two dangers in this approach. First, there is no guarantee that a lump sum payment will provide an income throughout the surviving spouse's entire lifetime. This is especially true in a time of economic uncertainty, when it is impossible to predict future inflation rates or increases in the cost of living. The advantage of joint and survivor annuity is obvious -- it provides a guarateed income throughout the life of the survivor. The second danger in shifting to a lump sum benefit is that many employers will be tempted to drop existing life insurance coverage of employees, assuming that the lump sum benefit will replace life insurance.

Section 3310 of S. 1541 would allow division of pension benefits according to the terms of state court decrees in divorce settlements. While we support the inclusion of this type of provision in any pension reform bill, we believe that the procedure established in section 3310 is too cumbersome. Both the Civil Service Act (PL 95-366) and section 103 of S. 888 allow the courts to order payment with minimal procedural requirements.

Section 4810, which would establish a "safe harbor" for pension plans with 4 year/ 40 percent vesting, is also of concern. The Internal Revenue Code provides a tax exemption for a pension plan only if it does not benefit higher paid employees and officers at the expense of lower paid employees. If 4 year/ 40 percent vesting is adopted as a "safe harbor," all pension plans using this schedule would be assumed to be in compliance with the nondiscrimination provisions of the Internal Revenue Code. While 4/40 is a relatively liberal schedule, experience has shown that there are specific groups of women who would suffer under this schedule. Women employed by professional corporations, (those formed by doctors, lawyers, dentists, etc.) are primarily at the lowest pay scales in those corporations and also have extremely short job tenure. Hundreds of thousands of women who are receptionists, nurses, secretaries, technicians, etc., employed by professional corporations would suffer if 4/40 were adopted.

Senator Don Nickles
November 9, 1981
Page 3

Last year, the IRS proposed regulatory changes which would have allowed the IRS to better monitor how pension plans actually function under the 4/40 rule and to require stricter standards where appropriate. BPW supported these proposed rule changes because it has been apparent for some time that there is serious discrimination against women by some of the corporations that use a 4 year/40 percent vesting schedule.

Finally, we oppose the provisions of section 4811 of S. 1541 which would allow more widespread integration of social security and pension benefits. Most workers earning less than the social security wage base, $32,400 in 1982, are hurt by integration. Women, clustered in the lowest paying occupations, are particularly affected by integration.

As it stands now, S. 1541 would do little to address any of the pension inequities which women face. We strongly urge the Subcommittee to give careful consideration to the pension provisions of S. 888 and to include these provisions as part of S. 1541. The growing poverty of older American women is a national disgrace. Significant pension reform is needed to begin to address this problem.

Sincerely,

Phyllis Harr

Phyllis Harrison
National President

PH/pd

WEAL
Women's Equity Action League
805 15th Street, N.W., Suite 822
Washington, D.C. 20005
(202) 638-1961

ECONOMIC EQUITY ACT

S.888 and H.R.3117

November 1981

24 Senators, under the leadership of Dave Durenberger(R-MN), Robert Packwood(R-OR) and Mark Hatfield(R-OR), are sponsors of a package of legislation whose aim is to begin the job of eliminating the economic inequities facing American women. Women's and civil rights groups played a key role in developing this bipartisan package.

On the House side, Pat Schroeder(D-CO) and Margaret Heckler(R-MA), co-chairs of the Congresswomen's Caucus, introduced an identical package along with 70 co-sponsors. Some of the bills have been introduced separately, but all are part of the E E A .

No activity as yet:

PRIVATE PENSION REFORM Introduced separately: H.R.1641 (Ferraro, D-NY)
Amends ERISA to lower pension plan participation age from 25 to 21; requires survivor's benefits if worker has put in 10 years but dies before retiring; requires written consent of both spouses before waiving survivor's benefits; eliminates the 2-yr. waiting period between electing and receiving survivor's benefits; gives a parent pension credits for up to 1 yr.'s leave of absence for child rearing if they return to same company; permits pension plans to pay a share of pension benefits to an ex-wife if court-ordered.

HEADS OF HOUSEHOLDS
Would permit single heads of households to use the $3,400 zero bracket amount available to married persons in figuring federal income taxes. Currently only $2,300.

CIVIL SERVICE RETIREMENT INCOME EQUITY ACT Intro. Sep.: H.R. 3040 (Schroeder, D-CO)
Assumes that the pension of a federal worker is part of the marital property and that an ex-wife or widow is entitled to a pro-rata share of the retirement benefits, subject to court review Survivor's benefits automatic unless ALL parties sign waiver of benefits.

TAX CREDITS FOR DISPLACED HOMEMAKERS Intro. Sep.: H.R. 835 (Ferraro, D-NY)
Gives tax credit to employers who hire displaced homemakers.

ARMED SERVICES
Eliminates differentiations between male and female commissioned officers in appointments, promotions, separation and retirement.

REGULATORY REFORM Introduced Separately: H.R. 2991 (Heckler, R-MA)
Federal agencies must review regulations to ensure sex neutrality.

Hearings held:

MILITARY RETIREMENT INCOME EQUITY ACT Intro. Sep.: H.R. 3039 (Schroeder) S.1648 (Hatfield)
Same provisions as Civil Service RIEA (see above). Senate hearings held Sept. 22, 1981, in Armed Services Subcommittee on Manpower & Personnel (Jepsen, R-IA, chair). House hearings scheduled for week of November 2 in Armed Services Subcommittee on Military Personnel & Compensation (Nichols, D-ALAB, chair).

NON-DISCRIMINATION IN INSURANCE Introduced Separately: H.R. 100 (Dingell, D-MICH)
Prohibits sex (and race or religion) discrimination in insurance, including life, auto, disability, health, annuity, et al. House hearings held May 22, 1981 in Energy & Commerce Subcommittee on Commerce, Transportation & Tourism (Florio, D-NJ, chair). No hearings scheduled as yet in Senate Finance committee.

Progress made:

INDIVIDUAL RETIREMENT ACCOUNTS (IRAs) FOR HOMEMAKERS
The 1981 tax bill raises the amount of spousal IRAs to $2250 and allows a non-working spouse to establish her own IRA based on her working spouse's earnings. Divorced homemakers can sustain their share of a spousal IRA up to $1,125.

CHILDCARE & DEPENDENT CARE TAX CREDIT
Added to the 1981 tax bill, raising credit limit to $4,800 and including a progressive sliding scale helping lower & middle income workers with dependents. Tax incentives were provided for employers to offer pre-paid daycare in their benefit packages. A Senate version making the credit REFUNDABLE for families with lower incomes was left out.

ESTATE TAX REFORM
Added to the 1981 tax bill, the "widow's tax" was repealed and spouses now presumed to share equally in family estate. Exemption from state tax raised to $600,000. Senate version of the Farm Bill also repeals credit preference statute, helping widows & single parents get federal farm credit. House must accept this amendment to Farm bill.

STUDY ON CHILD SUPPORT/ALIMONY PAYMENT ENFORCEMENT
Attached to Justice Department's authorization bill, but entire bill is stalled due to pro-busing filibuster.

RICHARD E. SHEPHERD
EXECUTIVE SECRETARY

TELEPHONE (405) 848-1832

NAMP

THE NATIONAL ASSOCIATION OF MATURE PEOPLE
2212 N.W. 50th • P.O. BOX 26792 • OKLAHOMA CITY, OKLAHOMA 73126

November 4, 1981

NOV 9 1981

Charlene Abshire
Senator Nickles Office
Russell Senate Office Bldg.
Washington, DC 20510

Dear Charlene:

Thank you for the invitation to travel to Washington and to present testimony to the Sub Committee on Labor chaired by Senator Nickles regarding the Pension Reform Act. Unfortunately, our budget will not permit me to travel to and from Washington at this time, but I do want the Sub Committee to know our concerns regarding the bill.

The Committee is urged to seriously consider the ramifications to employees of the three objections as set forth in my mailgram to Senator Nickles and my letter to Mr. Carroll dated October 9, 1981. They are:

1) The bill as written would permit a company to invest up to 50% of the total pension fund assets into its own company which most people would consider a poor investment practice in that it would jeapordize the employee's pension fund.

2) The bill as currently written would eliminate annual reports to individual employees regarding the status of the pension fund. This provision is not in the best interest of the individual employee and/or former employees who have vested rights in the pension fund.

3) The bill as written would permit suspension of a person's pension if the person returned to work after retirement. Such a provision is highly unfair to the employees or former employees especially in light of similar restrictions on the Social Security benefits which cause people financial hardships and removes them from our possible productive work force which would and could be beneficial to this nation.

Given the demographics of this country, it is obvious that we will soon need to encourage older people to continue to work beyond age 65.

Thank you for calling these matters to the Committee.

Sincerely,

Richard E. Shepherd

RES/es
cc: Senator Nickles
Charles Carroll, Jr.

AICPA
American Institute of Certified Public Accountants
1211 Avenue of the Americas, New York, New York 10036 (212) 575-6200

November 11, 1981

The Honorable Don Nickles
6327 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Nickles:

Re: S-1541

As Chairman of the AICPA Committee on Employee Benefit Plans and ERISA I would like to take this opportunity to alert you to certain concerns the public accounting profession has with respect to section 3202 of the proposed "Retirement Income Incentives and Administrative Simplification Act of 1981."

The provisions of section 3202 are similar to those previously submitted to the Congress in 1979 in S-209 and other proposed legislation. The requirements for opinions of actuaries and accountants are changed to require that those professionals "shall" rely on each other's opinion rather than they "may" rely.

As we have previously testified before the Senate Committee on Human Resources, the benefits of ERISA's requirement for an independent audit are not fully realized under the current law or the permissive regulations of the Department of Labor that permit major restrictions on the scope of the audit. The independent auditor's work regarding trusteed assets and actuarial information does not duplicate the work of a bank or insurance company or an actuary. To mandate the auditor's reliance on actuarial and bank-certified information would further limit the benefit available to plan participants from the independent audit.

I am enclosing the statement of the American Institute of Certified Public Accountants to the U.S. Senate Committee on Human Resources, which I presented on February 8, 1979. The concerns expressed at that time were similar to those presented at the joint hearing held on August 19, 1978, by the Senate Human Resources Committee on Labor and the Senate Finance Subcommittee on Private Pension Plans and Employee Fringe Benefits.

Should you or your staff have any questions with respect to the attached statement or wish to receive further amplification of any of the views expressed therein please do not hesitate to contact me. I may be reached either through the AICPA, 1211 Avenue of the Americas, New York, New York, 10036, (212) 575-6373 or directly at my office, Peat, Marwick, Mitchell & Co., 345 Park Avenue, New York, New York, 10022, (212) 758-9700.

Thank you for taking the time to consider the view of the American Institute of Certified Public Accountants on this important matter.

Very truly yours,

AICPA Committee on Employee
Benefit Plans and ERISA

Andrew J. Capelli

A. J. Capelli
Chairman

AJC:ngr
Attachments

cc: Charles T. Carroll
T. C. Barreaux
Jeffrey Clayton

American Podiatry Association

STATEMENT

of

HERBERT ROTHFELD, DPM
PRESIDENT, AMERICAN PODIATRY ASSOCIATION

on

S.1541: Retirement Income Incentives and Administrative Simplification Act of 1981

to

Subcommittee on Labor
Committee on Labor and Human Resources
U.S. Senate

November 4, 1981

20 Chevy Chase Circle, N. W. • Washington, D. C. 20015 • 202-537-4900

Mr. Chairman, Members of the Subcommittee:

INTRODUCTION

I am Dr. Herbert Rothfeld, President of the American Podiatry Association. Residing and practicing in Hyattsville, Maryland, I am most pleased to be here today representing the Nation's doctors of podiatric medicine. Though the subject of today's hearings is a most important one for podiatric medicine, I intend to keep my remarks brief recognizing the busy agenda with which the Subcommittee is faced.

In our view, the Employee Retirement Income Security Act, 1974 (ERISA), has proven to be an extremely important legislative achievement. By providing necessary protection for the retirement and welfare benefits of millions of American workers and their families, ERISA has been a godsend. But its significance holds even greater potential when one considers the future increase in the number of retirees. Thus, these hearings, which seek ways to consolidate, simplify, and improve ERISA's administration, are both timely and necessary. Consistent with the purpose of these hearings, my testimony today is designed to identify for you a problem podiatrists have been encountering with self insured ERISA health and welfare plans. Because the problem to be subsequently detailed is one which, we believe, the architects of ERISA neither intended nor anticipated, we recommend a remedy which we consider to be fully consistent with the objectives of the Act.

THE PROBLEM

Presently, a variety of states possess some form of a "freedom of choice" insurance statute. Such statues are designed to protect the consumer's right to select a licensed practitioner of his or her choice to render needed health or medical care. Third party carriers or insurance companies operating in these jurisdictions must respect these state level "freedom of choice" laws by honoring and reimbursing the patient's choice of a licensed practitioner for the delivery of needed, professional services. In other words, an insurance contract which provides coverage for foot care must respect the consumer's right to select either a medical doctor or a podiatrist to furnish such care.

Though ERISA's preemption clause was predicated on very constructive and sound reasoning, its application has frequently deviated from preemption's original intent. I refer to the fact that a variety of self insured ERISA health and welfare plans have chosen to avoid those state "freedom of choice" statutes by limiting the reimbursement for foot care to that rendered by doctors of medicine and osteopathy. This practice, we strongly feel, is not only an unwarranted infringement on a patient's "freedom of choice," it is also contrary to the original intent of ERISA's preemption clause.

PREEMPTION AND HEALTH BENEFIT COVERAGE

As we understand the Congressional history on ERISA, we note that the preemption clause was intended to insure that restrictive state laws would not stand in the way of employers' attempts to establish comprehensive benefit programs for their employees.

In most instances, preemption has had a desirable effect. But with regard to podiatry and state level "freedom of choice" laws, an opposite effect is being felt, one which limits rather than broadens the range of services from which a beneficiary can choose. To repeat, this application of preemption is completely contrary to the law's intent. Furthermore, we fail to find any public interest purpose whatsoever being served when preemption is applied in these instances.

• SOLUTION

Mr. Chairman, we are pleased to note that S.1541 attempts to address this problem area. In Section 3605 of the measure, the following language appears:

> "(ii)(I)A provision of State law which provides that one or more specific benefits must be provided or made available by a contract or policy of insurance issued to an employee benefit plan or which provides that one or more particular classes of individuals must be provided benefits under such a contract or policy is a law which relates to an employee benefit plan within the meaning of subparagraph (A) and is not a law which regulates insurance within the meaning of subsection (a).

The problem with this proposed language is that it would not apply to self insured ERISA plans, only to those which engage private, third party carriers to administer benefit packages. Furthermore, the impact of this amendatory language could be altogether moot, since state "freedom of choice" laws already impact on insurance companies operating within state boundaries. So the remedy proposed by S.1541 is at best superfluous.

Instead, we prefer and propose a broader solution than that proposed above. It reads as follows:

> A provision of state law which requires that a contract, a policy of insurance, or an employee benefit plan may not classify the services of any provider of health care services as ineligible for coverage or equal reimbursement, solely because such provider is licensed by the state as a provider of health care services other than those rendered by a medical doctor, is a provision of law described in subparagraph (A) and not a provision of law described in subsection (a).

This language, unlike that presently proposed by S.1541, would require that self insured ERISA plans in states where "freedom of choice" statutes prevail may not classify practitioner services as ineligible for coverage simply because they are rendered by one other than a medical doctor.

CONCLUSION

In full recognition of the importance of ERISA's preemption clause and the assault being mounted against it by others, I am mindful of the Subcommittee's reluctance to dilute the clause in any way. But is it dilution when the preemption clause is being used in ways never intended nor authorized by its originators? We think not and, thus, merely seek to sustain the constructive feature of the clause, namely, to ensure that restrictive state laws would not stand in the way of employers' attempts to set up comprehensive benefit plans for their employees.

Mr. Chairman, I appreciate the opportunity to appear before the subcommittee and look forward to responding to any and all questions you might have. Meanwhile, I am hopeful a satisfactory solution to this dilemma can be found and implemented.

AMERICAN BAR ASSOCIATION

GOVERNMENTAL RELATIONS OFFICE • 1800 M STREET, N.W. • WASHINGTON, D.C. 20036 • (202) 331-2200

STATEMENT OF

E. CHARLES EICHENBAUM, CHAIRMAN
STANDING COMMITTEE ON RETIREMENT OF LAWYERS

and

JAMES T. O'HARA, CHAIRMAN
SUBCOMMITTEE ON LEGISLATION
STANDING COMMITTEE ON RETIREMENT OF LAWYERS

on behalf of the

AMERICAN BAR ASSOCIATION

submitted to the

SUBCOMMITTEE ON LABOR
COMMITTEE ON LABOR AND HUMAN RESOURCES

UNITED STATES SENATE

concerning

RETIREMENT INCOME INCENTIVES AND
ADMINISTRATIVE SIMPLIFICATION ACT OF 1981
S. 1541

December 2, 1981

SUMMARY

Under existing law, there continues to be substantial and unjustifiable disparity in tax treatment with respect to the contributions and benefits available to corporate employees and self-employed persons under qualified retirement plans. Annual contributions of up to $41,500 may currently be made to a defined contribution plan for a corporate employee, while a self-employed person may currently contribute only a maximum of $7,500 per year. The employee limitation is adjusted for cost-of-living increases, while the $7,500 limitation is not. Moreover, a corporate employee may currently accrue a benefit, payable in the form of a 100% joint and survivor annuity in the case of married individuals, up to $124,500 under a defined benefit plan; whereas a self-employed person's annuity would only be roughly comparable to what could be purchased with a maximum annual contribution of $7,500 to a defined contribution plan. Although the current $7,500 contribution limitation will increase to $15,000 for taxable years beginning in 1982, there is no policy justification for the continued discrimination against the self-employed. The American Bar Association urges that S. 1541 be amended to eliminate this unsupportable discrimination against self-employed individuals by increasing the maximum limitation on deductible contributions that are permitted for self-employed plans, allowing adjustments for cost-of-living increases, providing comparable social security integration rules and eliminating the duplicative set of special restrictions that apply only to plans covering the self-employed.

Mr. Chairman, and Members of the Subcommittee:

We appreciate this opportunity to present the views of the American Bar Association regarding § 4809 of S. 1541, the "Retirement Income Incentives and Administrative Simplification Act of 1981." We are E. Charles Eichenbaum, Chairman of the Standing Committee on Retirement of Lawyers, and James T. O'Hara, Chairman of the Subcommittee on Legislation of the Standing Committee on Retirement of Lawyers. The Association urges the elimination of the unsupportable disparity in the levels of contributions and benefits under qualified retirement plans between those for corporate employees and those for the benefit of self-employed persons, and the removal of other restrictions that apply only to self-employed plans.

The American Bar Association acknowledges the recent increase in the limits on deductible contributions from $7,500 to $15,000, which is part of the Economic Recovery Tax Act of 1981 (ERTA) and is reflected in § 4809 of S. 1541. We believe that was a step in the right direction, but it represents only a small reduction in the existing disparity in annual contributions. The Association believes that serious consideration should be given to an amendment to S. 1541 which would eliminate the substantial residual disparity. Such an amendment would greatly simplify the administration of the "Employee Retirement Income Security Act of 1974" (ERISA) and is greatly overdue because present laws unfairly discriminate against the self-employed. The existing disparity has had the effect of increasing the costs of doing business, imposing undue administrative burdens, encouraging the incorporation of self-employed persons, and reducing the amount of retirement investment that would otherwise be made.

The firm commitment of the American Bar Association to changes in present laws governing qualified retirement plans is expressed in the following outstanding resolutions of the Association:

> BE IT RESOLVED, That the Internal Revenue Code of 1954 should be amended by eliminating all differences in treatment of self-employed persons with respect to qualified employee benefit plans and all other employee benefits; and
>
> BE IT FURTHER RESOLVED, That at the least, the limitations on contributions to, or benefits from, qualified employee benefit plans should be the same for both employees and self-employed persons and should provide for adjustments for increases in the cost of living as is presently provided with respect to plans for employees.

The President of the American Bar Association believes that this subject is sufficiently important to be one of the major priorities of the Association. Accordingly, the objective of tax parity for the self-employed has been made a Presidential Priority of the Association.

Background -- H.R.10, ERISA, and ERTA

Qualified retirement plans provide benefits for individuals covered thereunder and the Nation as a whole. Such plans have provided millions of employees with privately funded retirement benefits. In addition, the contributions to such plans are a major source of capital formation and the creation of jobs.

The tax benefits from qualified retirement plans represent by far the most valuable tax benefit provided by Congress to employees. Employer contributions for the benefit of employees are not taxable to the employees when made, even though the employees' rights may be vested and the amounts are held in trust for them.[1] The investment earnings on such funds held for employees are generally tax-exempt.[2] Employees are taxable on such amounts when they receive their benefits, usually after retirement.[3] Even then, if the amounts are received as a "lump sum distribution," the income tax treatment is extremely favorable. The tax deferral effect, whereby no income tax is imposed on such funds or the investment earnings thereon for long periods of years, plus the taxation of such amounts after retirement, often in lower brackets or as lump sum distributions, provides major incentives to save for retirement through such prorations.

In addition, the funds accumulated for an employee based on employer contributions and deductible employee contributions, may be distributed free of estate tax.[4] Qualified plans must also provide coverage that does not favor shareholder-employees, officers, or highly-paid employees.

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[1] IRC § 402(a).

[2] IRC § 501(a).

[3] IRC §§ 402(a) and 72.

[4] IRC § 2039(c),(f).

Prior to 1962, self-employed persons could not participate in such qualified plans to any extent. In 1962, the H.R. 10 or Keogh provisions were adopted permitting annual contributions by self-employed persons of up to $2,500.[5/] Congress also imposed a complex structure of special requirements and restrictions on plans covering certain self-employed individuals in addition to those regularly imposed by the Internal Revenue Code on all qualified plans. There was some justification for these special limitations and restrictions on self-employed plans at that time because the tax law contained inadequate provisions to prevent skewing of benefits in favor of owner-employees.

In 1974, Congress adopted ERISA, imposing a comprehensive set of restrictions and limitations on all qualified retirement plans, including plans covering the self-employed. Contributions by an employer to a "defined contribution plan"[6/] on behalf of any employee were limited to $25,000 per year. This limit is adjusted annually for cost-of-living increases.[7/] For plan year

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[5/] The deduction, though not the contribution, was limited to $1,250 from 1962 to 1964.

[6/] A "defined contribution plan" is a plan such as a money purchase pension plan, profit-sharing plan, or stock bonus plan under which amounts contributed for particular employees are accounted for in separate accounts for them. The amounts are held in trust, and investment earnings are credited to employees' separate accounts. The employee subsequently receives (usually after retirement) an annuity for himself, or himself and his spouse, or a lump sum payment, based on whatever his separate account will provide.

[7/] IRC § 415(d).

ending in 1981, the limit is $41,500.[8] Contributions to a "defined benefit plan"[9] were originally limited so that no employee could receive an annuity after retirement exceeding $75,000 per year, payable in the form of a 100% joint and survivor annuity in the case of a married participant. That limitation is also adjusted annually to reflect cost-of-living changes, and, at present, the adjusted limitation is $124,500.[10]

In contrast to this, ERISA increased the limit on deductible contributions by self-employed persons from $2,500 to only $7,500.[11] This amount is not adjusted to reflect cost-of-living changes. Further, although ERISA imposes on all qualified plans a uniform and comprehensive set of restrictions governing participation, vesting, funding, insurance and benefits, prohibited transactions, and other matters, Congress failed to eliminate the

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8/ See I.R. News Rel. IR-81-16, February 4, 1981.

9/ A "defined benefit plan" is an aggregate-funded pension plan under which separate accounts are not maintained for employees. Employees are provided pre-determined annuities or other benefits after retirement determined by their earnings level, years of service, age, or a combination of these factors. The employer must contribute whatever amount (determined actuarially) is required each year to fund these future pre-determined benefits. The essential difference from a defined contribution plan is that the employer takes the investment risk in a defined benefit plan while the employee does so in a defined contribution plan.

10/ *Supra* note 8.

11/ IRC § 404(e)

duplicative, cumbersome, and more severe set of restrictions covering these same subjects which already applied to plans covering the self-employed.

As noted earlier, ERTA increased the limit on deductible contributions by self-employed persons from $7,500 to $15,000 for taxable years beginning in 1982.[12/] However, during 1982, contributions to a calendar year defined contribution plan may be made for a corporate employee of up to approximately $46,705, assuming a cost-of-living increase based on the 1981 percentage increase. This disparity will continue to grow as inflation continues, since the contribution limitation for corporate employees is indexed while the $15,000 limitation for the self-employed is not. It is clear that ERTA did not adequately deal with the discrimination between corporate employees and the self-employed. This continuing discrimination has caused a widespread growth in the number of professional corporations and partnerships of professional corporations. If remedial legislation is not enacted, and assuming the recent rate of inflation continues, the gap will again attain its pre-ERTA level in the near future.

Reasons for Eliminating the Differences in Treatment of Self-Employed and Employee Plans

By enacting legislation which would remove the discrimination against self-employed plans, Congress would greatly simplify

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[12/] Id.

the administration of our tax laws and ERISA. Self-employed plans are subject not only to all of the restrictions and limitations imposed by ERISA on all qualified plans, but also to the special H.R. 10 restrictions and limitations. The restrictions that are applicable to self-employed plans are excessively complex. They unduly complicate the administration of our national retirement system and are confusing to small businessmen and businesswomen assessing retirement plan alternatives. The President's Commission on Pension Policy stated that "individuals in all types of pension programs should be treated more equally regarding contributions and benefit limitations."[13] The Commission also has referred to the current tax treatment of retirement contributions and benefits as "needlessly complex and inconsistent."[14]

As we have previously stated, the disparity in the benefits available to corporate employees and self-employed persons is blatantly unjust and inequitable. No tax policy or other reasonable justification exists for this discrimination against the self-employed. This fact has been recognized by past administrations, who opposed legislative changes in this area not on grounds of principle but solely because a revenue loss might result.

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[13] Interim Report of the President's Commission on Pension Policy, at 25 (May 23, 1980).

[14] The President's Commission on Pension Policy, Coming of Age: Toward a National Retirement Income Policy, at 8 (Feb. 26, 1981).

However, any revenue loss estimates are, to some extent, illusory. The increasing trend of small business incorporations means that fewer businesses are using self-employed plans. The incorporation trend has, of course, been principally fueled by the existing disadvantageous treatment of self-employed retirement plans. Finally, it is likely that the removal of existing differences in the limits on deductible contributions to corporate defined contribution plans and self-employed plans would result in no greater revenue loss to the Treasury than resulted from the recent ERTA increase to $15,000 or the limit on deductible contributions to self-employed plans. The revenue loss should be so limited because many professionals, who are in a position to make greater retirement contributions, have since incorporated or are seriously considering doing so and many other unincorporated individuals would presently not he in a position to make a contribution in excess of $15,000.

The discrimination against self-employed plans also increases costs and uncertainties for many small businesses. As noted above, the relatively advantageous treatment of defined contribution plans has encouraged many small businesses to incorporate. Incorporating increases the administrative costs of a small business which would be more efficiently conducted as a sole proprietorship. Further, small businessmen who incorporate bear the risk that their corporate arrangements will be challenged by the IRS or struck down by the courts. In three recent cases involving incorporated individual businessmen, the IRS has argued (on one occasion successfully) that the income reported by the corporate entity involved should be reallocated for income tax purposes to the principal shareholder.[15] In each of these cases, however, the court acknowledged that one of the purposes for the incorporations was to take advantage of the difference in retirement benefits.

The continued discrimination against self-employed plans, as evidenced by the recent ERTA changes, has created even stronger pressure to form professional corporations. Yet some professional organizations which conduct their business in more than one state are inhibited from incorporating because of nonreciprocal or conflicting laws among the applicable states. As a result, the professional corporation option is fraught with uncertainties and increased costs and may not be an available option for multi-state businesses. Finally, the incorporation trend, which may be further spurred by the three recent Tax Court cases, will heavily burden the government's tax and pension enforcement programs as the resulting litigation and rulemaking increase in an effort to keep pace with this rapidly growing trend.

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[15] See Achiro v. Commissioner, 77 T.C. No. 62 (October 19, 1981); Keller v. Commissioner, 77 T.C. No. 70 (October 29, 1981); Foglesong v. Commissioner, 77 T.C. No. 74 (November 16, 1981).

The current Administration is placing heavy emphasis on stimulating savings and investment, and, thus, capital formation, through the tax system. It is clearly evident that increasing the tax benefits available to self-employed persons through qualified retirement plans will induce a higher level of savings than would otherwise occur. Therefore, Congress should enact legislation which eliminates the inappropriate and unfair discrimination against self-employed individuals, by increasing the maximum limitation on deductible contributions and benefits that are permitted for self-employed plans, allowing adjustments for cost-of-living increases, and eliminating the duplicative set of special H.R. 10 restrictions that apply only to self-employed plans. In short, it should end the discrimination between retirement plans for corporate employees and the self-employed. There are no policy reasons for continuing these obsolete distinctions. The changes advocated are important steps toward achieving the goal of the President's Commission on Pension Policy to "provide all individuals greater incentives to save for retirement and help attain the goals of an adequate retirement income."[16]

We would be pleased to submit a proposed amendment containing suggested changes to the Internal Revenue Code that would provide retirement parity for the self-employed and finally bring to an end the existing disparity between them and their incorporated colleagues. Once again, on behalf of the American Bar Association, we thank the Chairman and the Subcommittee for permitting us to present these views.

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[16] The President's Commission on Pension Policy, supra, at 49.

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W. M. Read
Senior Vice President

NOV 5 '81

November 3, 1981

The Honorable Don Nickles
Chairman
SENATE SUBCOMMITTEE ON LABOR
Dirksen Senate Office Building
Washington, D. C. 20510

Subject: S. 1541

Dear Senator:

Atlantic Richfield has reviewed S. 1541 and generally supports its provisions. We are pleased that attempts are being made to simplify ERISA's paperwork burden, and we believe that S. 1541 can accomplish this without weakening the protection that ERISA extends to the American worker.

Attached to this letter is a summary of our position on selected provisions of S. 1541. Our comments are offered constructively, and we are happy to provide any additional information that may be required.

Very truly yours,

W. M. Read

WMR:mg

Attachment

ATTACHMENT: S. 1541

Atlantic Richfield opposes the idea of one super-agency to enforce federal pension regulation of employee benefits. Consolidating all of ERISA's functions under the EBA to ensure a smooth enforcement of ERISA requirements is a beguiling idea. However, we do not believe that favorable results will accrue in practice. The majority of administrative problems arose in the years immediately following enactment of ERISA, and were due largely to the creation of enforcement mechanisms to implement a new law. However, President Carter's Reorganization Plan No. 4 has eliminated most of the administrative problems; we believe that the creation of a new administrative agency might, in fact, recreate some of the administrative nightmares that plan sponsors experienced immediately after passage of ERISA. We are also wary of what the creation of a brand-new bureaucracy entails. For example, it is entirely conceivable that the perspective of one of the merged agencies may dominate in the new arrangement, with consequent unfavorable effects on both employers and employees. We therefore oppose Title I in its entirety.

Atlantic Richfield supports Section 3101. We also believe that statutory recognition should be given to treating, as welfare plans, those severance pay arrangements where payment extends beyond two years. In addition, we recommend that that the Secretary of Labor be empowered to exempt, by regulation, these arrangements from all of ERISA's requirements relating to welfare plans.

On the face of it, Section 3202 appears to work in favor of reducing duplicative work and administrative costs. Proposed Section 3202 contradicts the statement on auditing standards No. 11, paragraph 336.08. The ability of CPAs and actuaries to determine the reasonablenesse of the others' work, is a valuable tool that can be used to obtain and report accurate information. We believe that reliance by these professions should be discretionary, because problems will occur if forced reliance exists. Accordingly, we oppose this section.

Section 3403 contradicts IRS Reg. 1.412(c)(3)-1, which prohibits taking into account any provision of a plan which is not effective. We feel that the IRS position is reasonable, and from a plan sponsor's point of view, a requirement such as the one proposed in Section 3403 is not desirable because of the consequent accelerated costs of funding plans, and the introduction of significant additional complexity. An example of this complexity are the regulations that will be required to establish appropriate adjustments to the funding standard account of a plan, if a provision never became effective. We therefore oppose this section.

We strongly support Section 3505. In 1978, the Company applied to the Department of Labor for an exemption from the prohibited transaction rules. The exemption was sought for a proposed contribution of a parcel of land worth $7.5 million to a trust of certain retirement plans sponsored by the Company. Independent appraisals showed that the transaction, if consummated, would be of great financial benefit to the trust. In spite of this, the Company had to go through the process of applying for an exemption, which took over six months and cost approximately $60,000. Had Section 3505 been in effect in 1978, we would have been spared the expense and trouble of applying for the exemption.

We strongly support any legislative attempt to strengthen federal preemption of state laws which apply to employee benefit plans, and we support proposed Section 3605. However, Section 3605, as drafted, will allow state insurance law to require conversion features in insurance policies and contracts, as well as permit "freedom of choices" provisions in policies and contracts. There are presently over a dozen **non-uniform** state health conversion and continuation laws. Explicitly exempting these laws from ERISA preemption means that insurance companies will have to assure that policies meet all of the various state provisions. In addition, conversion and continuation privileges are expensive. We therefore oppose this particular feature of the proposal.

We support Section 4806. A qualified trust should be allowed to borrow on an insurance contract using the contract as security, and without having the transaction considered acquisition indebtedness.

We support Section 4807. Atlantic Richfield believes that employees who desire and who are able to work beyond age 65 should be encouraged to do so. Section 415 of the Internal Revenue Code imposes certain limits on retirement benefits payable to employees who work beyond normal retirement age. These limits are disincentives to those older employees contemplating extension in their working concerns, and we favor eliminating these disincentives.

We oppose Section 4811. We do not believe that the solution to the complex problem of integrating retirement plans with Social Security is to subject such plans to new integration rules similar to those proposed in Section 4811. The proposals may well hamper any efforts at simplifying the current rules.

The Company opposes the proposals contained in Title V. We certainly support employee participation in IRAs; the Company, in fact, is presently considering implementing a payroll deduction system to enable employees to systematically put money aside and avail themselves of the tax deductions permitted by the ERTA. However, we oppose legislative attempts to introduce any degree of compulsion in the employer-employee relationship.

We understand that ERIC plans to offer detailed comments on Title VI when it testifies on this legislation later this week. We have discussed the issues raised by Title VI with ERIC's counsel, and we are in agreement on all substantive points. Atlantic Richfield, both as a Company and as a member of ERIC, supports the proposed legislation embodied in Title VI.

Investment Company Institute
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DEC 1 1981

November 30, 1981

The Honorable Don Nickles
Chairman, Subcommittee on Labor
of the Senate Committee on Labor and
Human Resources
4230 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Senator Nickles:

On November 9, 1981, in testimony before the Subcommittee on Labor of the Senate Committee on Labor and Human Resources, the American Bankers Association (the ABA) requested legislation exempting bank-sponsored pooled investment funds for Keogh plans and Individual Retirement Accounts from regulation under the federal securities laws. The Investment Company Institute* respectfully submits the attached memorandum in opposition to the legislative proposal put forth by the ABA.

The Institute and its members have extensive experience and expertise relating to Keogh plans and IRAs. We actively participated in the legislative process which led to the enactment of the 1962 federal tax legislation which first permitted self-employed persons to establish Keogh plans, and in the enactment of the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) relating to Keogh plans and IRAs. The Institute and its members also participated in the legislative process which resulted in the 1970 amendments to the federal securities laws relating to pooled investment funds sold to retirement plans.

It is ironic, indeed, that the ABA is currently actively supporting legislation before the Senate Committee on Banking, Housing and Urban Affairs which would subject new bank-sponsored pooled investment funds to the federal securities laws and at the same time is pursuing legislation in this Subcommittee to exempt existing bank-sponsored pooled funds from those laws. However, regardless of the ABA's intentions, we believe that its proposal is without merit.

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* The Investment Company Institute is the national association of the American mutual fund industry. Its membership includes 642 open-end investment companies ("mutual funds") their investment advisers and principal underwriters. Its mutual fund members have assets of about $211 billion, and have approximately 13 million shareholders.

Adoption of the ABA's proposal would give rise to the very abuses which Congress in 1970 and 1974 sought to prevent -- the mass-marketing of interests in bank-sponsored pooled investment funds to hundreds of thousands of Keogh plans, IRAs and their individual participants without the protections afforded by the federal securities laws. Congressional hearings in the last Congress demonstrated that serious abuses currently are taking place with respect to bank collective investment funds sold to other retirement plans due to present exemptions from the federal securities laws. During those hearings, both the Securities and Exchange Commission and the Department of Labor testified in opposition to the ABA's proposal. Indeed, Congress repeatedly has declined to further exempt bank pooled investment funds from the federal securities laws.

The ABA's proposal must be viewed in light of a complete understanding of Keogh plans and IRAs. Most Keogh plans and IRAs tend to be very small and have very few participants: a recent Institute study indicates that the average Keogh plan has only 1.4 participants, and IRAs typically have only one participant. Many Keogh plans and all IRAs permit each participant, and not the employer, to select his or her own investments from among various alternative funding media. Many, if not most, Keogh plans and almost all IRAs are not covered by ERISA. More importantly, ERISA only seeks to protect a participant with respect to his or her plan; ERISA does not purport to protect Keogh plans, IRAs and their individual participants when they invest in pooled investment funds.

If the ABA's proposal is adopted, banks would be free to run aggressive advertising campaigns, using the types of advertisements attached as Exhibit A, advertisements which led a recent Chairman of the Senate Banking Committee to express "astonishment" over the present lack of SEC jurisdiction with respect to bank pooled investment funds sold to corporate retirement plans. Additionally, hard factual evidence (a study of the sales literature used by 17 banks pooled funds) indicates that the ABA proposal will have the affect of denying Keogh plans, IRAs and the participants in such plans adequate information on which to base their investment decisions. Finally, adoption of the ABA's proposal will deny participants in IRAs the substantive protections provided by the Investment Company Act of 1940.

For the reasons set forth above and in the attached memorandum, we strongly urge that the Subcommittee reject this latest attempt by the ABA to achieve repeal of the federal securities laws as they relate to bank-sponsored pooled investment funds sold to Keogh plans and IRAs.

We respectfully request that this letter and the attached memorandum be included in the hearing record.

We would be pleased to furnish any additional information which the Subcommittee or its staff may request.

Sincerely,

William M. Tartikoff

William M. Tartikoff
Assistant Counsel

Attachments

MEMORANDUM OF THE INVESTMENT COMPANY INSTITUTE IN RESPONSE TO THE AMERICAN BANKERS ASSOCIATION'S PROPOSAL TO AMEND THE SECURITIES ACT OF 1933 AND THE INVESTMENT COMPANY ACT OF 1940 BEFORE THE SUBCOMMITTEE ON LABOR OF THE SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES

NOVEMBER 30, 1981

In testimony before the Subcommittee on Labor on November 9, 1981, the American Bankers Association (the ABA) requested amendments to the federal securities laws exempting bank-sponsored pooled investment funds sold to Keogh plans and Individual Retirement Accounts (IRAs) from regulation under those laws. Yet only three weeks before, on October 20, 1981, the ABA testified before the Senate Committee on Banking, Housing and Urban Development in favor of legislation which would authorize banks to sponsor pooled investment funds for all investors and to subject these funds to regulation under the federal securities laws.

For the reasons stated below, the Investment Company Institute* opposes the ABA's proposal.

1. The Senate Banking Committee is currently reviewing proposals, including those advocated by the ABA, regarding bank securities activities and the regulation of these activities under the federal securities laws.
2. In 1970, Congress amended the Securities Act of 1933 (the 1933 Act) in order to assure that participants in Keogh plans investing in bank pooled investment funds receive the disclosure protections of the 1933 Act.

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* The Investment Company Institute is the national association of the American mutual fund industry. Its membership includes 642 open-end investment companies ("mutual funds") their investment advisers and principal underwriters. Its mutual fund members have assets of about $211 billion, and have approximately 13 million shareholders.

3. In 1974, when Congress enacted the Employee Retirement Income Security Act (ERISA) permitting the creation of IRAs, it sought to provide IRA participants with both the disclosure protection of the 1933 Act and the substantive protections afforded by the Investment Company Act of 1940 (the 1940 Act).

4. Subsequent Congressional hearings have demonstrated that serious abuses are currently taking place with respect to bank pooled investment funds sold to corporate retirement plans due to the present exemptions for such funds from the federal securities laws.

5. Congress repeatedly has declined to further exempt bank pooled investment funds for retirement plans from federal securities regulation.

6. Keogh plans, IRAs and their participants need the protections afforded by the federal securities laws since Keogh plans and IRAs tend to be small; many Keogh plans and all IRAs permit each participant (rather than the employer) to select his or her own investments; many, if not most, Keogh plans and IRAs are not covered by ERISA; and, in any event ERISA does not purport to provide the protection afforded by the federal securities laws.

7. Adoption of the ABA proposal would permit commercial banks to mass-merchandise interests in their pooled investment funds to Keogh plans, IRAs and individual participants in such plans through aggressive advertising campaigns without providing adequate disclosures on which the plans and their participants could base their investment decisions, and would deprive IRA participants of the substantive protections of the 1940 Act.

Each of these matters is discussed in detail below.

Current Congressional Review of Bank Securities Activities

The Senate Committee on Banking, Housing and Urban Affairs is currently reviewing legislation (S. 1720) which, among other things, would permit banks to sponsor mutual funds and to sell such funds to the general public, including Keogh plans and IRAs. The proposal would subject these funds to regulation under the

Securities Act of 1933 and the Investment Company Act of 1940. On October 20, 1981, the American Bankers Association testified in strong support of this legislation.*

We believe that it is ironic, indeed, that the ABA testified before this Subcommittee on November 9th calling for the removal of securities law protections for participants in existing bank pooled funds and at the same time supports proposals before the Senate Banking Committee which would subject new bank pooled funds to regulation under the federal securities laws.

It should also be noted, that the House Committee on Banking, Finance and Urban Affairs has already scheduled hearings on the major issues involving the financial services industry, including bank securities activities.**

We respectfully submit that legislation to amend the federal securities laws should be considered by the respective Senate and House Committees with jurisdiction over those laws (the Senate Banking Committee, the House Banking Committee and the House Energy and Commerce Committee), rather than by the Senate Labor Committee. This is particularly true with respect to the ABA's proposal since the banking Committees in both Houses of Congress are currently considering the very issues of the regulation of bank securities activities under the federal securities laws.

1970 Legislation Relating to Keogh Plans

In 1955, the Federal Reserve Board first authorized national banks to form collective investment funds for the commingling of assets of corporate retirement plans managed by a bank. *** Jurisdiction over these funds was transferred to the Comptroller of the Currency in 1962. The Comptroller's regulations prohibited the merchandising and advertising of interests in these funds to corporate plans. * Therefore, the Securities and Exchange Commission (the SEC) took the position that interests in these pooled funds were exempt from registration under the 1933 Act based on the private offering exemption. **

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* See Statement of the ABA at hearings before the Senate Committee on Banking, Housing and Urban Affairs on the "Financial Institutions Restructuring and Services Act of 1981," on October 20, 1981, at p. 350:

> "The ABA has prepared a draft proposal that would authorize banks and S&Ls to sponsor and sell mutual funds. The funds would be fully subject to the Securities Act of 1933 and The Investment Company Act of 1940, thus providing regulatory equality."

** See House Committee on Banking, Finance and Urban Affairs "Financial Institutions In A Revolutionary ERA", October, 1981

*** 30 Fed. Reg. 3305 (1955).

However, the enactment of the Self-Employed Individuals Tax Retirement Act of 1962 *** created a new situation. The 1962 Act permitted self-employed individuals for the first time to create retirement plans ("Keogh plans") covering themselves and their employees. Since annual contributions to Keogh plans were sharply limited ($2,500 up to 10% of self-employed income), banks could only appeal to the Keogh market using interests in their pooled investment funds on an "assembly-line approach." **** Since banks openly sought to mass-merchandise shares of their pooled investment funds to Keogh plans, the SEC naturally took the position that the shares had to be registered and prospectuses provided to prospective investors. * Committees in both Houses of Congress repeatedly considered this issue from 1967 through 1970. SEC Chairman Cohen testified in favor of legislation codifying the SEC's position exempting interests in bank pooled investment funds for corporate plans from registration. However, he opposed legislation which would have removed the SEC's disclosure jurisdiction over bank pooled investment funds for Keogh plans: "[Keogh] plans involve a complex arrangement for the investment of funds by self-employed persons, small businessmen and their employees for retirement purposes in a diversified portfolio of equity securities. There is a need for adequate and understandable disclosure concerning the risks, obligations, rights and costs which are involved." **

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* 28 Fed. Reg. 3312 (1963); 12 C.F.R. §9.18(b)(5)(iv)(1964).

** See SEC Memorandum re Securities Act Release No. 4552, reprinted in Hearings on Common Trust Funds--Overlapping Responsibility and Conflict in Regulation Before a Subcomm. of the House Comm. on Government Operations, 88th Cong., 1st Sess., (1963) (hereinafter cited as 1963 Hearings): "The Commission has consistently taken the position that the commingling of corporate pension plans and the operation of common trust funds involves the issuance of a security--although often in a transaction not involving a public offering."

*** Pub. L. No. 87-792, 76 Stat. 809.

**** See, e.g., "A Fork in the Road," Address by G.T. Lumpkin, Jr., Vice President, Wachovia Bank & Trust Co. Before the 44th Midwinter Trust Conference of the American Bankers Association, New York City, N.Y. (Feb. 5, 1963):

"[Corporate] plans usually involved large sums well diversified, to provide future security for their hundreds of beneficiaries. Now comes the opportunity to serve as trustee of hundreds (or thousands) of very small [Keogh] retirement trusts.

"This is a dramatic change in the nature of trust business. We must meet it with a mind open to possible dramatic change in approach. Rather than the close personal basis on which other types of trust service have been handled, we must look toward an assembly-line approach, a semiautomated approach, or even possibly a fully automated approach. Rather than a daily, weekly, or monthly personal contact with a trust customer, we must look to an indirect yearly contact, in many cases through an annual statement mailed to his home or business address. Rather than a trust customer judging us on his intimate knowledge of our service to him to fill his personal needs, he will be judging us strictly on the investment return he receives. Rather than a man-to-man relationship, we must consider a machine-to-man concept of fiduciairy service."

After some three years of hearings in both Houses, Congress enacted the Investment Company Act Amendments of 1970, which adopted the pattern which the SEC had applied. Bank and insurance company pooled investment funds for corporate plans and Keogh plans were exempted from registration as investment companies (Investment Company Act of 1940, Section 3(c)(11)). Interests in pooled investment funds sold to corporate plans were exempted from registration under the Securities Act of 1933 (Section 3 (a)(2)). But interests in pooled investment funds sold to Keogh plans were required to be registered under the 1933 Act, with the SEC given authority to issue appropriate exemptions (Section 3(a)(2)):

> "The amendment does not exempt [from the 1933 Act] interests or participations issued by either bank collective trust funds or insurance company separate accounts in connection with 'H.R. 10 plans,' because of their fairly complex nature as an equity investment

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* "Since it is clear that participations in the pooled fund will be publicly offered, registration of the security with this Commission is required under the Securities Act of 1933." Testimony of SEC Chairman William L. Cary, 1963 Hearings, at 7. And as another SEC Chairman, Ray Garrett, Jr., stated with respect to bank pooled funds: "If a bank operates and distributes shares of something that is indistinguishable from a mutual fund for all purposes except legal form should it not be subject to the same regulation as the mutual fund itself?" Address of Chairman Ray Garrett, Jr., Before 55th National Trust Conference, 15-16 (February 4, 1974).

** Statement of SEC Chairman Manual F. Cohen at Hearings Before the Senate Committee on Banking and Currency on Amendment No. 438 to S. 1659, 90th Cong. 1st Sess., at 1328 (1968).

It should be emphasized that ERISA was enacted to protect participants in employee benefits plans. However, ERISA does not attempt to regulate the matters covered by the federal securities laws. For example, ERISA seeks to provide a participant in a plan with information concerning the plan itself, by requiring that the participant receive a summary plan description and an annual plan report. However, when an employee benefit plan (or a participant in a plan) purchases shares in a pooled investment fund, be it a bank pooled investment fund, an insurance company pooled separate account or a mutual fund, it does so on the same basis as any other investor. It is the federal securities laws, not ERISA, which require sponsors of pooled investment funds to provide Keogh plans, IRAs and their participants with prospectuses describing the pooled fund. It is the federal securities laws, not ERISA, which limit the types of advertisements which sponsors of pooled investment funds can direct at Keogh plans, IRAs and their participants. It is the federal securities laws, not ERISA, which provide Keogh plans, IRAs and their participants with the right to sue sponsors of pooled funds for fraud and misrepresentations in connection with the purchase of shares of the pooled fund.

Subsequent Congressional Concerns With Bank Pooled Investment Funds for Retirement Plans

Since the enactment of the 1970 legislation which subjected bank pooled investment funds for Keogh plans to the 1933 Act registration requirements and the enactment of ERISA which subjected bank pooled investment funds for IRAs to the 1933 and 1940 Act, the ABA repeatedly has sought legislation which would remove these requirements. As the following chronology demonstrates, Congress not only repeatedly has declined to enact such legislation, but has reaffirmed SEC jurisdiction over bank pooled investment funds sold to Keogh plans and IRAs.

First, in 1975, when the Senate Securities Subcommittee was considering the Securities Acts Amendments of 1975, the ABA requested amendments exempting bank pooled investment funds for Keogh plans and IRAs from the federal securities laws.* The Subcommittee did not report out the legislation requested by the ABA.

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* See Hearings on S. 249 Before the Senate Subcomm. on Securities, 94th Cong., 1st Sess. (1975), at 463-75.

Second, in 1978, the ABA testified before the Subcommittee on Oversight of the House Ways and Means Committee urging legislation exempting bank pooled investment funds for IRAs from the federal securities laws.* The Committee did not report out the legislation requested by the ABA.

Third, in 1978, major pension reform legislation, S. 3017, the ERISA Improvements Act of 1978, was introduced by the then Chairman, Senator Williams, of the Senate Committee on Human Resources and the ranking minority member Senator Javits. Section 274 of the bill contained a provision, suggested by the ABA, which would have removed SEC jurisdiction over bank pooled investment funds sold to Keogh plans and IRAs. The provision was vigorously opposed by both the SEC and the Department of Labor. SEC Chairman Williams stated: "...with respect to registration under the Securities Act, it is important to note that, while ERISA requires pension plans to make disclosures to their participants, ERISA generally does not regulate the disclosures which a bank or insurance company makes to self-employed individual who wishes to establish an IRA."** Chairman Williams also added his support for continuing the protections afforded IRA participants by the 1940 Act.*** Secretary of Labor Marshall stated:

> "Subparagraphs (b) and (c) deal with banks and insurance companies investing the assets of benefit plans through single or collective trusts or through separate accounts. It is possible that this proposal might encourage insurance companies and banks to render greater services to plans at a lower cost. However, we are not aware of any study which shows that the application of the securities laws has discouraged services to plans or that this proposal remedies any detrimental effect of the securities laws.

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* See Hearings on Individual Retirement Accounts and IRS Plan Termination Survey Before the Subcomm. on Oversight of the House Ways and Means Comm., 95th Cong., 2d Sess. (1978), at 191-93.

** Statement of SEC Chairman Williams, Joint Hearings on S. 3017 Before the Subcomm. on Labor of the Senate Comm. on Human Resources and the Subcomm. on Private Pension Plans and Employee Fringe Benefits of the Senate Comm. on Finance, 95th Cong., 2d Sess., at 347 (1978). (Hereinafter cited as 1978 Hearings).

*** H.R. Rep. No. 93-1280, 93rd Cong., 1st Sess. at p. 354.

On the other hand, the proposal would deprive many plans of existing and longstanding protections of securities laws traditionally applied to anyone (including small plans) in the commingled funds." (Emphasis added.)*

The Investment Company Institute presented graphic evidence of the actual abuses which would take place if SEC jurisdiction over bank pooled investment funds for Keogh plans and IRAs was removed.**

First, we discussed abuses in advertising. As noted above, the SEC administratively had exempted interests in bank pooled investment funds sold to corporate plans from registration under the 1933 Act based on the private offering exemption (a position codified by Congress in 1970) at a time when regulations of the Comptroller of the Currency prohibited merchandising and advertising of these pooled funds to corporate plans. However, after the SEC and Congress acted to exempt these interests from the 1933 Act, the Comptroller suddenly amended his regulations so as to permit national banks to advertise and publicize their pooled investment funds sold to corporate retirement plans.*** We attached to our testimony representative advertisements being run by banks aimed at corporate retirement plans (similar advertisements are attached to this memorandum as Exhibit A), and stated that if bank pooled investment funds for Keogh plans and IRAs were exempted from the 1933 Act. "... banks would be free to advertise interests in their pooled investment funds to employee benefit Keogh plans and IRAs, with no restraints whatever imposed by ERISA or the federal banking laws. These small plans will be told by United Jersey Bank that "We're #1 nationally in investment performance'; by Hibernia National Bank that it is '#1'; and by the Fifth Third Bank of Cincinnati that it is 'Entering our second decade of outperforming the Dow Jones.'"****

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* Submission of Secretary of Labor Ray Marshall to Honorable Harrison A. Williams, Jr., Chairman, Senate Committee on Human Resources, September 8, 1978, at 9.

** Statement of the Investment Company Institute, 1978 Hearings, at 798.

*** 37 Fed. Reg. 24161, at 24162 (1972).

**** Statement of the Investment Company Institute, 1978 Hearings at 836.

Second, we discussed abuses in the area of disclosure. We stated that if bank pooled investment funds for Keogh plans and IRAs were exempted from the 1933 Act, banks would not be required by ERISA or the federal banking laws to provide Keogh plans and IRAs and their participants with prospectuses, but would be free to utilize any sort of sales material they desire. In order to demonstrate exactly what would occur if bank pooled investment funds for Keogh plans were exempted from the 1933 Act, we examined material which 17 banks provide to prospective Keogh plan investors concerning the banks' pooled investment funds (which take advantage of present exemptions from the 1933 Act since they allegedly are only offered to Keogh plans in one state).* Our examination of these documents was to determine whether Keogh plans and Keogh plan participants investing in these pooled funds are being provided with the most basic kind of information deemed essential under the federal securities laws. The lack of such disclosures is startling. None of the 17 banks describe the fund's investment restrictions; none provide relevant information describing the bank operating and advising the fund; none give background information regarding the bank's officers and directors; none disclose the total fees paid to the bank in each of the last three years; none disclose the amounts of brokerage commissions paid by the fund or to whom; and over half do not contain the fund's current financial statements or the fund's current portfolio. In contrast, every mutual fund registered under the Investment Company Act must continuously provide all of this information to all prospective investors, including Keogh plans, and IRAs and their participants. Thus, this study of 17 bank pooled investment funds which are exempt from the 1933 Act demonstrated the point made by SEC Chairman Williams and Secretary of Labor Marshall--it is the federal securities laws, and not ERISA, which require sponsors of pooled investment funds to make disclosures to Keogh plans and plan participants concerning their pooled funds. We noted that the Federal Trade Commission's Bureau of Consumer Protection recently had issued a lengthy report critizing the inadequate disclosure provided to IRA participants who invest in product which presently are not subject to the federal securities laws (e.g., bank savings accounts and certificates of deposit).* We noted that exempting bank pooled investment funds for Keogh plans, and IRAs would place these Keogh plans, and IRAs and their participants in exactly the same position as the unprotected IRAs discussed in the FTC report.**

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* These banks, which we selected on a random basis, were: Bank of Southwest (Houston); Capitol National Bank (Houston); The Central Trust Company (Cincinnati); Citibank (New York); The Fifth Third Bank (Cincinnati); First Virginia Bank (Falls Church); First National Bank (Cincinnati); First Pennsylvania Bank (Philadelphia); Girard Trust Bank (Philadelphia); Maryland National Bank (Baltimore); Mercantile-Safe Deposit & Trust Co. (Baltimore); National City Bank (Cleveland); New England Merchants National Bank (Boston); Philadelphia National Bank (Philadelphia); Provident National Bank (Philadelphia); Shawmut Bank of Boston (Boston); and Southern Ohio Bank (Cincinnati).

Third, following our testimony we retained outside counsel to study the impact of the 1970 amendments which exempted bank pooled investment funds for Keogh plans from substantive regulation under the Investment Company Act. Counsel reviewed the operations of six bank-sponsored pooled investment funds for Keogh plans based on prospectuses on file with the SEC. The law firm's report (a copy of which is attached as Exhibit B) stated:

> "The study demonstrates that in many instances in the bank managers of these unregulated funds arrogate to themselves completely unfettered discretion to change investment policies and advisory fees without the consent of investors. The banks are also able to obscure their advisory fees by excluding them from disclosed expense ratios. The absence of 1940 Act regulation also allows the banks to delay honoring investor redemption requests, to avoid reporting to shareholders, and to use the fund's brokerage commissions without regulatory restrictions."
>
> "Most important of all, the regulatory vacuum created by the exemption from 1940 Act regulation allows the banks to profit from self-dealing transactions with their funds. Thus, banks can maximize the funds' interest-free deposits with the banks by delaying investments of new deposits and by keeping the funds' portfolios in a 'liquid position.' They also invest fund assets in certificates of deposit issued by their own banks. Such self-dealing would be illegal if the funds were registered under the 1940 Act. Thus, the study makes clear, notwithstanding registration under the Securities Act of 1933, disclosure by itself, even disclosure administered by the SEC, is not sufficient. It is the strongest evidence that protection of participants in managed investment funds requires 1940 Act regulation."

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* Staff Report of the Bureau of Consumer Protection of the Federal Trade Commission Submitted to the Subcommittee on Oversight of the House Ways and Means Committee on Individual Retirement Accounts/Annuities (IRAs), dated March 1978. Also see the FTC's comments on proposed ERISA Prohibited Transaction Exemption 77-9, urging increased disclosure requirements.

** Statement of the Investment Company Institute, 1978 Hearings, at 837-38.

We believe that this study raises serious questions about the continued wisdom of exempting bank pooled investment funds for Keogh plans from the type of substantive regulation contained in the Investment Company Act of 1940.*

The testimony of the SEC and the Department of Labor and the evidence submitted by the Institute at the hearings on the 1978 bill evidently convinced the Chairman and the ranking minority member of the Senate Committee to conclude that, rather than decreasing federal regulation over bank pooled investment funds sold to employee benefit plans, legislation should be enacted increasing federal regulation in this area. In 1979, they reintroduced their bill as S. 209, the ERISA Improvements Act of 1979, and included a provision, Section 154, providing that, while the SEC was to lose its limited jurisdiction with respect to bank pooled investment funds sold to retirement plans, the Secretary of Labor was to be mandated to prescribe regulations relating to advertising, disclosure and "such other standards as the Secretary may specify to protect plan participants and beneficiaries." Thus, bank pooled investment funds sold to corporate plans would, for the first time, have been subject to federal regulation in the areas of advertising, disclosure and substantive requirements. Federal regulation over bank pooled investment funds for Keogh plans would have been expanded to include substantive regulation.

SEC Chairman Williams testified that these provisions represented an improvement over the 1978 bill, but questioned the fragmentation of securities regulation between the Commission and the Department of Labor.** Secretary of Labor Marshall stated that, since the Department lacked expertise in this area and the SEC possessed such expertise, more study was needed in this area.*** The Institute stated that, while the provision was a substantial improvement over the 1978 bill, securities type jurisdiction should be vested in the SEC, the agency expressly created by Congress to regulate securities matters.* Following the hearings, the Senate Committee on Labor and Human Resources reported out the bill, deleting Section 154.

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* This problem is not limited to bank pooled investment funds sold to Keogh plans, but involves tens of thousands of corporate plans and billions of dollars. The American Bankers Association recently reported that bank pooled investment funds for corporate retirement plans had assets of $47.5 billion at year-end of 1978. American Bankers Association 1980 "Collective Investment Funds Survey Report", at 7.

** Statement of the Securities and Exchange Commission, Hearings on S. 209 Before the Senate Comm. on Labor & Human Resources, 96th Cong., 1st Sess. (1979(, 657 at 658. (Hereinafter cited as 1979 Hearings).

*** Statement of Secretary of Labor Marshall, 1979 Hearings, 124 at 199.

When S. 209 went to the Senate Finance Committee for consideration, the ABA again proposed that bank-sponsored pooled funds for IRAs and Keogh plans be exempted from the securities law.** The Senate Finance Committee did not report out S. 209, and took no action with respect to the ABA proposal.***

The legislative history of S. 3017 and S. 209 demonstrates that serious abuses are occurring in this area and that leading members of the Labor Committee were concerned with increasing federal regulation over these pooled funds, not with decreasing existing regulation.

This view is shared by other members of Congress, by two recent SEC Commissioners and by the present Chairman of the SEC.

In 1978, the Institute testified before the Senate Committee on Banking, Housing and Urban Affairs on S. 72, a Bill to Amend the Bank Holding Company Act and the Bank Merger Act. Our testimony called the Committee's attention to representative advertisements being run by banks for their pooled investment funds for corporate retirement plans. The following exchange took place between then Chairman Proxmire and the president of the Institute:

> "The Chairman. Has the SEC indicated any interest in this because they seem to be so blatant and so conspicuous, as you say: 'entering our second decade to outperforming the Dow Jones, 'Your fixed-income fund has got to deliver superior results, 'Its about time investment managers were judged on their success instead of their addresses,' in the Birmingham bank with a crow sitting on a directions sign, New York to Dallas, Atlanta and Birmingham, which is a great place. 'Your company's employee benefit plan can't profit from a bad fit.'

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* Statement of the Investment Company Institute, 1979 Hearings, 711, at 719-20.

** See ABA Statement before the Subcommittee on Private Pension Plans of the Senate Finance Committee on S. 209 dated December 5, 1979, at p. 11.

*** In fact, the ABA presented its proposal yet again to the Finance Committee this spring in testimony before the Subcommittee on Savings Pensions and Investment Policy on June 12, 1981. The Subcommittee has taken no action in response to the ABA request.

> "These are all banks that have fine conservative reputations. Its astonishing that they can do this and the SEC has no authority, no jurisdiction, and they can do that in competition of course with your industry. It just doesn't seem to be logical at all. Either what the SEC is doing in restraining the [mutual fund] industry is wrong, which I think it is not--I think it's right--or the banks should be restrained on the same basis."
>
> "Mr. Silver. I fully agree, Mr. Chairman."
>
> "The Chairman. When you talk about competition, that obviously isn't fair competition."*

In 1979, the Chairman and other members of the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Banking Committee introduced legislation, H.R. 2747, which would have ended these abuses by prohibiting national banks from advertising and merchandising interests in their pooled investment funds to corporate retirement plans. In his testimony, SEC Chairman Williams called attention to the fact that Congress had exempted bank pooled investment funds for corporate retirement plans at a time when regulations of the Comptroller of the Currency prohibited merchandising and advertising, but that:

> "In a sharp departure from this historical setting, however, regulations of the Comptroller of the Currency were recently amended to provide that general advertising prohibitions--which embodied the policies underlying the exemption provided in the Securities Act--are no longer applicable to collective investment trust funds maintained by banks for corporate pension funds. As a result, many banks have begun to market interests in those trust funds aggressively through general advertising about the investment performance of those corporate pension trusts. Although these bank trust funds compete with other collective investment media such as investment companies and insurance company separate accounts, which generally are subject to the registration provisions of the Securities Act, individual plan participants in the corporate pension plans purchasing interests in bank trust funds may be denied the protection afforded under the Securities Act to which they would be entitled if their corporate pension plan administrators had chosen to invest in these competing media."**

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* Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs on S. 72, 95th Cong., 2d Sess. (1978), at 348.

** Statement of SEC Chairman Harold M. Williams Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs. Regarding H.R. 1539, H.R. 2747 and H.R. 2856 October 17, 1979,at 17.

Chairman Williams also stated that:

> "It would be anomalous if all financial institutions offering investment advice to the general public, whether directly through publicly-solicited individual advisory relationships or indirectly through publicly-solicited collective investment management arrangements like investment companies, were not subject to the same regulatory requirements, the same fiduciary responsibilities, and the same degree of enforcement presence."*

Subsequently, SEC Commissioner Friedman also indicated that all bank pooled investment funds for retirement plans should be subject to SEC regulation:

> "In general, the Investment Company Act and the Investment Advisers Act should apply to bank investment management. Why should an independent investment manager who manages funds for pension funds and other institutions be regulated by the SEC as an investment adviser while a bank is not? Why should they be subject to different rules regarding their ability to advertise or their fiduciary obligations?
>
> "If banks are managing an entity that is the functional equivalent of a mutual fund or a closed-end investment company there is no reason to have different rules regarding self-dealing, pricing, approval of investment management fees, and the like. The need for independent directors is as great as in a mutual fund complex. This is not simply a matter of competitive equity. The regulatory pattern for investment management is essentially sound. It responds to real problems that were rife in the investment company industry in the 1920's and were replicated in the REIT experience of the 1970s. Its logic and benefits are no less applicable to banks than to other investment managers.
>
> "Moreover, it is not clear to me that all of the past regulatory compromises regarding the Securities Act of 1933 continue to make a lot of sense. In those plans in which the employee has an investment decision to make, the result looks very much like an investment company. Whether or not any of the employee's money is invested in the employer's securities would seem to have little to do with what ought to be the result in terms of disclosure."**

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* Ibid at 15-16.

** Investment Management and the Glass-Steagall Act-the Emperor's New Clothes, Remarks to the Association of Bank Holding Companies, November 13, 1980, at 12-13.

Current SEC Chairman Shad recently testified before the Senate Banking Committee:

> "Bank trust departments have traditionally provided investment management services in connection with common trust funds and employee benefit plans. These common trust funds and collective funds are generally exempt from the provisions of the Investment Company Act of 1940 so long as the funds are maintained "exclusively for the collective investment and reinvestment of monies contributed thereto by the bank" in it's fiduciary capacity, or if they consist solely of assets of tax-qualified corporate employee benefit plans. When banks go beyond that, however, to market their investment management services to the public, the common trust funds or other commingled accounts managed by the banks may well become investment companies subject to the companies subject to the Investment Company Act. Again, although the question is not free from doubt, there are arguments that suggest the desirability of transferring all such accounts to the registered affiliate, at least if the bank markets its advisory services to the public."*

In summary, Congressional hearings since the enactment of the 1970 legislation relating to Keogh plans and the 1974 legislation relating to IRAs demonstrate that there now exists inadequate regulation with respect to bank pooled investment funds sold to Keogh plans and other retirement plans due to present exemptions from the federal securities laws. Therefore, Congress has repeatedly refused to enact legislation which would further reduce existing regulation in this area. We submit that the Congress should be extremely wary of enacting exemptive laws which decrease existing regulation, thereby opening the way to even greater abuses than presently exist.

In order to understand the impact of the ABA's proposed legislation on Keogh plans, IRAs and their millions of individual participants, it is necessary to understand some basic facts regarding Keogh plans and IRAs.

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* Statement of SEC Chairman John Shad before the Senate Committee on Banking, Housing and Urban Affairs on S. 1720, October 30, 1981, at 12.

Nature of Keogh Plans and IRAs

(a) Keogh plans and IRAs tend to be very small and cover very few participants. In 1978, the Institute conducted a study of Keogh plans funded with mutual fund shares (which accounted for over 30% of all Keogh plans assets). We found that at year-end 1977, the average Keogh plan funded with mutual fund shares had assets of only $8,106 and only 1.4 participants. (In contrast, at year-end 1975, the average corporate plan had assets of $425,000 and 60 participants).* IRAs typically cover only one individual, and at year-end 1979, IRAs funded with mutual fund shares had, on the average, only $5,223 per account.

(b) Many Keogh plans and all IRAs, permit each participant (rather than the employer) to select his or her own investments from among various alternative funding media. Thus, in these cases, it is each participant, and not the employer, who selects the particular funding media for his or her own account.

(c) Many, if not most, Keogh plans and IRAs are not covered by Title I or ERISA.** ERISA, Title I, only applies to plans which cover employees.*** Thus almost all IRAs are exempt from ERISA. Further, a Keogh plan which only covers a sole proprietor is not covered by Title I, and regulations also exempt a Keogh plan which only covers a sole proprietor and his or her spouse.**** In addition, regulations exempt a Keogh plan which only covers partners and not employees.***** Thus, given the small size of the average Keogh plan (1.4 participants), it is likely that many, if not most, Keogh plans are not covered by Title I of ERISA.

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* Statement of the Investment Company Institute, 1978 Hearings, at 845. More recent information confirms the findings of our 1978 study. At mid-year 1980, the average Keogh plan funded with mutual fund shares has assets of only $16,013 and only 1.4 participants, with an average individual account size of $11,477. At mid-year 1980, the average individual Keogh account at mutual savings banks was even smaller, with assets of only $6,496. See Table 4, Analysis of Monthly Savings Bank Trends, National Association of Mutual Savings Banks, September 25, 1980.

** Title I of ERISA contains the fiduciary, reporting and enforcement provisions of the law.

*** ERISA §3(2)(A)

**** ERISA Reg. §2510. 3-3(c)(1)

*****ERISA Reg. §2510. 303(b). See, e.g., Securities Act Release No. 5989, an application filed by a Keogh plan employer for a Commission order exempting interests in its Keogh plan: "The Plan [only] covers the Applicant's partners...Applicant states that because the Plan covers persons, all of whom are employees [e.g. partners] within the meaning of Section 401(c)(1) of the Code, the Plan is not an "employee pension plan' under Title 1 of ERISA".

These basic facts concerning Keogh plans and IRAs--the small size of most Keogh plans and IRAs; the fact that many Keogh plans and all IRAs allow each participant to select his or her own investments; and the fact that all IRAs and many, if not most, Keogh plans, are not covered by ERISA--have an important bearing on the ABA's legislative proposal to exempt interests in bank pooled investment funds sold to Keogh plans, IRAs and their participants from the federal securities laws.

Consequences of Adopting the Proposed Legislation

If the proposal is adopted, commercial banks would be free to mass-merchandise interests in their pooled investment funds to thousands of Keogh plans, IRAs and individual participants in such plans without any restraints whatever imposed by ERISA, the federal banking laws or the federal securities laws.

Banks would be free to run aggressive advertising campaigns using ads of the type attached hereto as Exhibit A. Thus, United Jersey Bank could run ads aimed at Keogh plans, IRAs and their participants stating "We're #1 nationally in investment performance"; Hibernia National Bank could advertise that it is "#1"; and The First National Bank and Trust Company of Tulsa could advertise that it has "First Place in the Pension Fund Playoffs."

Further, if the proposal is adopted, banks would be free to sell interests in their pooled investment funds to Keogh plans and IRAs without providing prospectuses and using any type of sales literature they desire. Our study of 17 bank-sponsored pooled Keogh funds (which take advantage of the intrastate exemption from the 1933 Act) demonstrates the disclosures (or rather the lack of disclosures) which will take place. Keogh plans, IRAs and their participants will not be provided with even the most basic information on which to base their investment decisions. They will not receive information concerning the fund's investment restrictions; the bank operating the fund; the officers and directors of the bank; the fees paid to the bank; the fund's policy with respect to buying and selling portfolio securities; and the amounts of brokerage commissions paid by the fund or to whom. In most cases, they will not receive any information regarding the fund's current financial statements or its current portfolio.

Finally, banks would be free to operate pooled investment funds for IRAs, in complete disregard of numerous provisions of the 1940 Act designed to prevent self-dealing transactions between the sponsoring banks and the pooled funds.

Conclusion

From the time that Congress first permitted individuals to establish Keogh plans and IRAs, Congress has been concerned that Keogh plans, IRAs and their individual participants receive the important investor protections provided by the federal securities laws. To achieve this result, Congress determined that interests in bank pooled investment funds sold to Keogh plans, IRAs and participants in such plans should be subject to the disclosure requirements of the Securities Act of 1933 and, in the case of IRAs, the substantive protections of the Investment Company Act of 1940.

The Senate and House Banking Committees are presently reviewing bank securities activities and their regulation under the federal securities laws. We believe that the evidence will continue to demonstrate that all bank pooled investment funds should be fully subject to regulation under the federal securities laws. This is especially true in the case of bank pooled funds for Keogh plans and IRA, since most Keogh plans and IRAs are small, and many Keogh plans and all IRAs permit each participant, rather than the employer, to select his or her own investments from alternative funding media. Moreover, many Keogh plans and IRAs are not subject to Title I of ERISA, and, in any event, ERISA does not purport to protect Keogh plans, IRAs and their participants when they invest in pooled investment funds.

We urge Congress to continue to protect Keogh plan and IRA participants by declining to enact legislation exempting bank pooled investment funds for Keogh plans and IRAs from the protections afforded by the federal securities laws.

Exhibits

**PROFIT Sharing Council
Of America**
SUITE 722 20 NORTH WACKER DRIVE
CHICAGO, ILLINOIS 60606 (312) 372-3411

DEC

December 3, 1981

The Honorable Don Nickles,
Chairman, Subcommittee on Labor
United States Senate
Committee on Labor and Human Resources
6321 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Nickles:

The Profit Sharing Council of America is a non-profit association of employers that maintain tax-qualified deferred profit sharing plans. Approximately 1,400 large and small employers located throughout the United States are members of the Council. The plans maintained by such employers cover approximately 1,750,000 employees.

The purpose of this statement is to offer to the Subcommittee the Council's views on the provisions of S. 1541 which affect profit sharing.

Title II of S. 1541 raises the age limit for individuals desiring to contribute to Individual Retirement Accounts (IRAs) from age 70-1/2 to age 75. In addition the same change in age limit would be applicable to the time at which distributions from an IRA must commence. The Council strongly supports these changes. The Economic Recovery Tax Act of 1981 (ERTA) will allow deductions for voluntary employee contributions to a qualified profit sharing plan. However, ERTA retains the age 70-1/2 limit on allowing employees to make such contributions to their qualified plans. The Council believes that as long as an individual remains an employee and a participant in his employer's qualified profit sharing plan, he should be allowed to make deductible contributions to the plan regardless of his age. The Council also recommends that the deduction allowed for voluntary employee contributions be extended to "mandatory" contributions as well.

Section 2004 of the bill adds a new Section 414(n) to the Internal Revenue Code which treats deductible employee contributions as employer contributions. The Council believes this change is highly desirable. Funds contributed to a qualified trust on a tax deductible basis should lose their separate identity once delivered to the trust, whether they be employer funds or employee funds. To treat the employee contributions on a completely different basis may force many plans not to permit employee deductible contributions. This might occur because of the very considerable administrative complexities in tracking and accounting for the different elements of the account and the income attributable thereto. In any event, such treatment will cause confusion on the part of employees and employers in the event of terminations or early retirement, and will result in complex and uneven tax treatment of a distribution upon retirement.

Title III makes a number of changes to ERISA and the Council is generally supportive of these changes.

Sections 3201 through 3212 deal with reporting and disclosure requirements. The Council urges reasoned restraint rather than wholesale relief. Ever since the enactment of ERISA, we have heard the horror stories of retirement plans being terminated, imminent plans being aborted, huge stacks of unopened forms and reports at IRS and Labor, and small employers, especially, being buried in a blizzard of ERISA spawned paperwork.

While some of this may be true, or all of it may be true to some extent, let us not forget the real problems that led to ERISA and to its sanctions aimed at protecting the employee and the employee's family. The large majority of employers always have and always will live up to their commitments to their employees. These employers need relief from some of the more onerous and burdensome requirements of ERISA. However, employees should not lose the protections afforded by ERISA, including full information on benefits and rights. Accordingly, the Council urges a rule of reason that will continue to make employers responsible for keeping plan participants and regulatory bodies informed. This can be done through a less firmly structured routine which will provide some relief to responsible employers while still giving meaningful, understandable and necessary information to the participant. The proposal to omit or lengthen the frequency of various reports and plan descriptions obviously will be met with favor in the business world. However, Summary Plan Descriptions and Summary Annual Reports are valuable information and communication tools between the plan sponsor and his employees. The Council feels that plan participants do need to know how well their plan funds are performing and do need to be kept informed periodically of the various provisions of their retirement plans. The Council therefore recommends that some reporting to plan participants is beneficial, but that the format should be left to the discretion of the plan sponsor. In this way, such reporting can be meaningful and informative, rather than being a strict statutory version which in many cases is simply ignored by the plan participant as being too legalistic and incomprehensible.

This also applies with respect to the notice to interested parties under Section 3208. We feel that such notice is helpful to employees, and that they do need the rights to comment on plan amendments, but plan sponsors should be given flexibility in the timing and content of such a notice.

The Council agrees with Sections 3209, 3301, and 3307, which deal with benefit statements being given only to vested terminees, the use of the plan year as a standard for measuring time for plan participation purposes, and simplification and clarification of rules governing seasonal employees.

Section 3309 deals with joint and survivor (J&S) annuities. Ever since ERISA, retirement plan sponsors and administrators have been troubled by the statutory J&S annuity provisions under Section 205 of the Act. When practitioners and the IRS concluded that the J&S annuity must be the primary form of distribution under any plan which offered any annuities, many plan sponsors simply deleted the annuity as an alternative under their plans. Others loaded their plans with all of the required jargon to satisfy the statutory J&S requirement, even though annuities were the exceptional mode of distribution, rather than the rule. This is especially the case in profit sharing plans. Under such plans, the participants or their beneficiaries always receive the full value of the account at retirement, death or disability, regardless of the presence or absence of the statutory J&S provision. The Council welcomes the change in this provision that Section 3309 of the bill brings to us.

Section 3310 of the bill clarifies and codifies the area of alimony and support payments. State courts throughout the country have ruled that the preemption and nonalienation provisions of ERISA should not and do not preclude state courts from protecting the rights of nonemployee spouses and dependents to employee benefits in the marriage dissolution and family support situation. The Council fully favors the provisions of Section 3310 of the bill. We therefore would opt for the consistency of the national policy that the bill will give to us. We particulary favor the provision which "...does not require the plan to alter the effective or commencement date, timing, form, duration, or total amount of any benefit payment under the plan..." (ERISA Sec. 206(d)(2)(B)(ii)). Thus, the employee's interest in the plan must be in pay status before it can be attached.

Under Section 3311 the elapsed time rules are clarified and the Council strongly favors this provision.

The Council fully supports Subtitle E of Title III, especially the prohibited transaction changes. The practice of requiring numberless plan sponsors to apply to the Labor Department for transaction exemptions is a gross waste of time and money, both for the government and industry. As we previously stated in discussing Subtitle B, let us use a rule of reason, which we think this bill provides. If the strictures of existing law are loosened, plan sponsors can act in a reasonable fashion without undue expense, and plan participants still have the right to bring suit in the event of imprudence or chicanery on the part of plan sponsors.

Section 3506 deals with qualified employer real property and we favor the change under the bill. However, the Council questions why such property must still qualify as multiple use property under section 407(d)(4)(B) of ERISA. It is felt that a rule of reason based on prudence is more desirable than a statute specifically setting investment policy.

The Council supports the aims of Subtitle F especially the provision in Section 3605(d) which states that pension rights are not considered a security under the Securities and Exchange Act.

The Council supports Section 4801 which amends Code Section 402(a)(2) to provide credit for participation in the plan of a predecessor employer or of another employer within this same controlled group. This recognizes the facts of modern business life, that companies are absorbed by companies, that mergers occur, that acquisitions are made, and that among controlled groups of employers, transfers are common and frequent. Such recognition can only serve the best interests of the plan participants, and give much needed flexibility to plan sponsors.

Section 4806 carries the concept of the elimination of certain debt financed income from the taxable income of a qualified trust. However, the Council feels that this concept should be broadened to exclude all prudent debt financed income, not just that income generated by transactions with an insurer under a life insurance contract.

The Council supports Section 4810 which establishes the so-called "4/40 vesting" as a definite safe harbor. This is a firm clarification of Congressional intent, and provides plan sponsors with one more area of certainty.

The Council wishes to commend the Subcommittee for providing a forum for comments on ways to simplify some of the more complex and restrictive provisions of the Employee Retirement Income Security Act of 1974. It is hoped that the enactment of these recommendations will act to encourage the adoption of more plans by employers and extension of retirement benefits to their employees.

Respectfully submitted,

Walt Holan

Walter Holan
President

md

STATEMENT OF THE
SUBCOMMITTEE ON PBGC - PENSION COMMITTEE
AMERICAN ACADEMY OF ACTUARIES
RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE SIMPLIFICATION ACT OF 1981 (S. 1541) - TITLE VI

December 3, 1981

I. INTRODUCTION

The Subcommittee on PBGC of the Pension Committee of the American Academy of Actuaries appreciates the opportunity to present this statement on Title VI of the Retirement Income Incentives and Administrative Simplification Act of 1981 (S. 1541). This statement supplements our earlier statement dated November 9, 1981 which addressed the first five Titles of the bill.

II. ELIMINATING PBGC INVOLVEMENT IN CERTAIN PLAN TERMINATIONS - SECTION 6106

Under present law, most defined benefit pension plans that are terminated by solvent employers provide employees with either full accrued benefits, the vested portion of accrued benefits, or the PBGC-guaranteed portion of vested accrued benefits. PBGC's involvement in these terminations has been to verify that the termination has been properly done and, in some cases, to provide the employer with an alternative to purchasing annuities from an insurance company. The elimination of this involvement -- as proposed in the bill -- should substantially reduce PBGC's administrative expenses without significantly impairing the benefit security of plan participants.

For plans which have unfunded vested benefits when they are terminated, the bill would require employer funding of such benefits instead of permitting the option of having benefits cut back to the PBGC-guaranteed level. This is, in essence, an increase in the level of benefits guaranteed to participants, with the attendant increase in employer costs. Employers no longer would have the flexibility of transferring liabilities to the PBGC. Therefore the PBGC would be exposed to less risk.

III. BILL DOES NOT ADDRESS TERMINATION OF FULLY FUNDED PLANS - SECTION 6106

Defined benefit plans generally are terminated for one of the following reasons:

(a) the employer goes out of business,
(b) operations are discontinued at a certain location, or
(c) the employer cannot afford to continue the plan or wishes to replace it with a defined contribution plan.

Much of the bill is intended to cover the situation in which the employer becomes insolvent. Where a solvent employer goes out of business, it will typically wish to fully fund at least vested benefits (the bill would prevent cutting back benefits), and the bill enables it to do so on an immediately tax deductible basis. The bill is not clear, but should be, that in the going-out-of-business situation, an employer with an overfunded plan can voluntarily terminate it to achieve a reversion of excess assets -- it is not clear whether or not ERISA section 4044(d) would only apply to "insurable events".

Where operations are discontinued, employers are presently free to continue to fund vested benefits over generally a 30-year period, and the bill would not seem to prevent this. If assets exceed the value of vested benefits, employers will presently typically terminate the plan either to achieve a reversion of excess assets or to allocate excess assets to nonvested employees, whichever is applicable. In some cases, the IRS will require such termination. The bill does not, but presumably should, clearly allow continuation of this practice.

Where operations continue, but the employer wishes to cease benefit accruals, employers are presently free to continue to fund accrued benefits over generally a 30-year period, provided service continues to accrue for vesting purposes, and the bill would not seem to prevent this. If the employer wishes to have nonvested benefits forfeited -- which is seldom the case where operations continue -- Section 6106 of the bill would accelerate funding as described in Section 6202 of the bill, and require annuities to be purchased when funding was completed. This latter requirement would seldom seem to have value and could, in fact, persuade an employer to fund such a plan as slowly as allowed. Furthermore, it could force an employer to purchase annuities at an inopportune time.

The bill does not make clear to what extent ERISA Section 4044 would apply when an insurable event does not coincide with plan termination. If assets exceed the value of vested benefits, the bill does not adequately provide that the plan can be terminated either to achieve a reversion of excess assets or to allocate excess assets to non-vested employees, whichever is applicable. The bill also does not address the situation where subsequent to plan termination, assets exceed the value of vested benefits even though they did not do so on the date of termination.

A limited number of solvent employers terminate plans under conditions where the value of unfunded benefits exceed 30% of the employer's net worth. In these situations, the PBGC presently shares in the cost of providing such benefits. The bill would eliminate this cost-sharing. This change would reduce the potential for abuse.

IV. NOTICE TO THE PBGC - SECTION 6115

Requiring notice of certain events suggestive of pending insolvency could strengthen the PBGC's position, provided the PBGC is able to put this information to its advantage, a task that is certainly formidable. In order to make the information available to the PBGC, the bill makes a potentially large group responsible for reporting this information to the PBGC. The bill also imposes personal financial liability which could be very large. This could make it difficult to find responsible individuals to serve plans in these capacities and could act as a drag on the adoption and improvement of defined benefit plans.

V. RETENTION OF LIABILITY UPON SALE OF BUSINESS - SECTIONS 6117 and 6119

The bill would affect controlled groups to which an insolvent employer formerly belonged. The bill would require such controlled groups to pay for such employer's unfunded benefits in certain circumstances. This could be required even where the employer's plan was fully funded for accrued benefits when it was spunoff from the controlled group. This requirement in that case could lead to the termination of plans at the time of sale simply to avoid a liability which could arise after the spinoff. Where benefits are not fully funded, some degree of protection for the PBGC seems reasonable, but we feel the degree of protection ought not to depend on such a subjective test as to whether or not one purpose of the spinoff was the avoidance of liability to the PBGC.

VI. STRICTER MINIMUM FUNDING REQUIREMENTS - SECTION 6202

The bill would strengthen PBGC's position by accelerating the funding of certain plans during their active lifetime. Some employers may desire to achieve a similar effect by requesting the enrolled actuary to anticipate plan amendments where such amendments can reasonably be expected -- for example, a flat dollar benefit plan with a history of the flat dollar rate being amended upwards on account of rising pay levels every several years. Allowing such employers to do so on a tax-deductible basis would be consistent with the other provisions of the bill.

The requirement to fund vested benefits over 15 years could result in considerable increased actuarial expenses -- for small plans of under 100 participants, for plans partially funded by life insurance policies, and for larger plans which value vested benefits at assumptions differing from the valuation assumptions.

VII. PREMIUM EXEMPTION FOR SMALL PLANS - SECTION 6103

Plans with less than 35 participants are to be exempted from paying annual premiums, presumably because the cost of collection exceeds the amount of premiums. If this relationship is the case, we suggest the premiums be restructured, for example a flat fee plus a per-participant fee. The elimination of premiums for small groups seems unfair.

VIII. LIABILITY UNDER MULTIPLE EMPLOYER PLANS - SECTION 6118

The bill provides for a liability to employers who withdraw from multiple employer plans, somewhat similar to the withdrawal liability established by the Multiemployer Pension Plan Amendments Act of 1980 for multiemployer plans, except this provision appears much simpler. This section will provide meaningful leverage for the insurance system to deal with the problem of providing promised plan benefits to the employees of withdrawing employers.

IX. CHANGE IN 30% NET WORTH LIMITATION - SECTION 6117

We have chosen not to comment on the priority status in bankruptcy of the PBGC's claim against employers. The bill changes the current 30% net worth limitation to an unlimited claim and gives it a status equal to that of other general creditors. We believe this could have significant impact on the willingness of employers to establish defined benefit plans or to grant benefit increases, as well as on their ability to obtain unencumbered credit instruments. This provision is an extremely important one and should receive the careful deliberation of the interested parties.

X. ISSUES NOT ADDRESSED BY THE BILL

We believe that a serious problem in the legislation is that it will cause the general public to believe that all the problems of termination insurance have been solved with its passage. Important inadequacies in the termination insurance program are not addressed. The current premium rate could not support the present level of guarantees for single employer plans should the bankruptcy of a major industrial company occur. The concept of coinsurance as it exists in the multiemployer legislation is completely absent from the single employer provisions. The principles of plan reorganization which permit plans to restructure liabilities in advance of insurable levels also would not be available to single employers.

XI. CONCLUSION

In summary, we again wish to express our gratitude for this opportunity to supplement our earlier statement on S. 1541 with commentary on Title VI. Representatives of the Academy are available to meet with the Subcommittee or staff at your convenience to discuss these proposals in more detail.

Douglas C. Borton, Chairman
Pension Committee

Subcommittee on PBGC
Norman W. Clausen, Chairman
David H. Gravitz, Vice Chairman
Robert B. Aglira
Joseph H. Dittmer
Edward N. Fleischer
Keath P. Gibson
Harrison Givens, Jr.
Claude R. Poulin

FINANCIAL EXECUTIVES INSTITUTE
633 THIRD AVENUE, NEW YORK, N.Y. 10017 · 212 953-0500

November 25, 1981

The Honorable Don Nickles
United States Senate
Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Nickles:

Title VI, S.1541

At this time, we are writing to present the position of the Committee on Employee Benefits of Financial Executives Institute regarding Title VI of S.1541, the Retirement Income Incentives and Administrative Simplifications Act of 1981. We intend to communicate our views on Titles I-V at a later date. Although we suggest in this letter certain further improvements with respect to the Plan Termination Insurance provisions of ERISA, we generally support the provisions of Title VI.

This statement of position is divided into two sections. In the first section, we discuss our views on some of the major issues in Title VI. In the second, we give our views on various other provisions of that Title.

MAJOR ISSUES

Redefinition of the insurable event. We support this provision. By redefining insurable event to cover basically only terminations where the plan sponsor's business is being liquidated, the Bill removes a flaw in the current law. Not only will the possibility of a healthy sponsor "dumping" unwanted pension liability on the PBGC be curbed, but also PBGC involvement with terminated pension plans will, in general, be reduced. This will serve to contain PBGC administrative expenses and will appropriately increase private sector involvement in the management of private pension plans.

Removal of the 30% net worth limitation on liability. We also

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support this provision, which, in combination with the redefinition of the insurable event, will substantially eliminate major potential avenues of abuse under current law.

Changes in employer obligation upon plan termination. Under current law, the employer obligation upon plan termination is a lump sum payment for the lesser of the present value of the unfunded PBGC guaranteed benefits or 30% of net worth. Under S.1541, this is revised to an ongoing obligation by the employer to the pension plan for the present value of unfunded vested benefits, to be amortized in payments over 15 years.

We accept this provision, but think, nonetheless, that it would be more appropriate not to mandate funding for the present value of unfunded vested benefits. Rather, only funding for guaranteed benefits should be mandated. Funding for the vested level should be permitted (and made tax deductible), but mandating this higher level could be too onerous for a company struggling to remain solvent.

Definition of guaranteed benefits. The Bill makes no change from current law in the definition of guaranteed benefits. Philosophically, we would endorse the principle of employee "coinsurance", which is, unfortunately, basically missing from current law with respect to single employer plans. The purpose of such "coinsurance" would be to distribute some risk of loss to employees, as well as to employers and the pension system.

Along similar lines, we think the Bill would be strengthened by inclusion of a more restrictive definition of guaranteed benefits. The PBGC has substantially broadened, by regulation, the scope of guaranteed benefits beyond original Congressional intent. Subsidized early retirement benefits and certain supplemental pension benefits have been guaranteed in this way. A provision which would limit guarantees to essentially the normal retirement benefit would greatly strengthen the financial position of the insurance system. Such a provision would also make the definition of guaranteed benefits more consistent with Congressional intent when ERISA was passed in 1974.

Contingent liability. We recognize that for any pension plan insurance system to work, some contingent liability must be recognized. Nonetheless, we think the whole area should be approached very cautiously and with careful consideration. We are not certain conceptually how the contingent liability ought best to be established. We do, however, have some specific criticisms of the Bill's provisions.

First, the 15 year period of potential liability is far too long. A 5-year period seems quite sufficient to protect the PBGC against abusive transactions.

Second, the exclusion of plans with less than 35 participants seems ill-advised. It is probable that at least as many problems will occur in such plans as in larger plans, and we can see no rationale for having the rest of the premium paying system give these plans a "free-ride."

Third, the exception to contingent liability in the event the net tangible assets of the buyer exceed those of the seller would seem to create a bias toward acquisitions only by the larger corporations. We think this would be an undesirable result in terms of the health of our overall economic system.

The above criticisms of the contingent liability provisions are by no means intended to be all-inclusive. We hope they do, however, underscore the need for the care which this area requires.

OTHER PROVISIONS

- Section 6103 of the Bill proposes eliminating premium for single employer plans with less than 35 participants. We oppose this provision: if small plans are to be covered by the insurance system, they must pay their own way. The argument about the cost to the PBGC of collecting premiums offsetting the loss of these premiums is weak. In the first place, this offset only holds at a $2.60 premium level. If premiums increase, this provision could represent a subsidy to small plans from large plans. Second, various provisions in the first five titles of the Bill, as well as the redefinition of insurable event, will hopefully serve to reduce greatly the current level of PBGC administrative expense. Finally, if it truly costs $50 - $60 for the PBGC to collect premiums per plan, this situation should be investigated and dealt with as a separate issue.
- We fully support Section 6104 of the Bill, which correctly links guaranteed benefit levels with premium sufficiency.
- Section 6106 would mandate the purchase of annuities if a terminated plan becomes sufficient. We believe this provision is a mistake, since the plan sponsor should be allowed reasonable financial flexibility in the management of

its plan. At the very least, a sponsor should be permitted to purchase annuities over some period of time.

- We support the prohibition of cash options under the circumstances described in Section 6114 of the Bill, which curbs a potential area of abuse. For purposes of protecting participants' rights, it is sufficient to limit payments to annuity forms.

- Section 6115 allows assessment of liability to all plan fiduciaries, company officers, and plan trustees (among others) if a reportable event is not reported. The reach of this provision is far too broad, and, in any case, adequate remedies exist under the current law.

- Section 6119 would allow contingent liability to be waived if any one of the following three tests is met: (1) net tangible assets of the buyer exceed the net tangible assets of the seller, (2) net tangible assets of the buyer exceed the plan's unfunded vested liability at the date of sale, or (3) there are fewer than 35 plan participants in the plan. We have already indicated (under the heading "contingent liability") our objection to the first test. In addition, this section provides that any waiver is subject to the PBGC's satisfaction that one of the tests is met. This latter condition is unduly onerous and should be deleted.

- We support the provisions of Section 6122, which properly assesses liability upon asset transfers made for the purpose of evading liability.

- Section 6202 would amend Internal Revenue Code Section 412 by strengthening ERISA's minimum funding standards in the various ways. We think that the existing funding standards have worked well and should not be changed. To the extent that there have been funding problems, it has been due primarily to the Internal Revenue Service's position that for a funding method to be "reasonable", for purposes of the funding requirements of Section 412 of the Code, the method must not anticipate future plan amendments (Regulation 1.412(c)(3)-1). In our opinion, the Bill would make a greater contribution to strengthening pension funding if a provision amending Section 412(c)(3) to allow methods to anticipate future amendments were included instead.

In conclusion, we feel you are to be congratulated for introducing such constructive legislation. Pension law is an area where there is much need for change. If you, or members of your staff, wish to discuss the matters raised in this letter, we would be pleased to do so and would welcome the opportunity to provide whatever assistance we can.

Sincerely,

J. R. Anderson

Jack R. Anderson
Chairman, Committee on Employee Benefits
Financial Executives Institute

cc: Other members, Senate Labor and Human
  Resources Committee
 Representative John N. Erlenborn
 Secretary of the Treasury
 Secretary of Labor
 Mr. William A. Niskanen, Pension Policy
  Working Group, Cabinet Council on
  Economic Affairs

LABOR'S CENTENNIAL
AFL-CIO
1881-1981

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DEC 10 1981

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December 7, 1981

Honorable Don Nickles, Chairman
Subcommittee on Labor
Senate Labor and Human Resources
Committee
United States Senate
Washington, D. C.

Dear Mr. Chairman:

The AFL-CIO appreciates the opportunity to present our views to the Subcommittee on Labor on S. 1541, the Retirement Income Incentives and Administrative Simplification Act.

It is important to state at the outset that we continue to give wholehearted support to the Employee Retirement Income Security Act (ERISA). The AFL-CIO supported enactment of ERISA because we thought it would be beneficial to workers and their families. Like most laws it is not perfect. Though we are not satisfied with a number of its provisions and particularly with some aspects of its administration, we still feel the law is beneficial and support its basic provisions.

Many provisions of S. 1541 are unsatisfactory and others are deserving of support. However, since we feel this is not the appropriate time for consideration of omnibus legislation to amend ERISA, we will not discuss the various provisions of the bill. Any attempt at this time to amend legislation as complex and affecting so many interests as ERISA might result in enactment of unsatisfactory amendments many of which could result in serious cutbacks in important protections of the pension rights of workers and retirees. Thus clamor over the enactment of this legislation is certain to result in ill-advised amendments to the law in any pension bill going through Congress -- contrary to whatever may be the present intention of the supporters of S. 1541.

For example, the recent multiemployer termination insurance legislation made sweeping changes in that program. Time is required for rational implementation of this complex legislation. The statute provides sufficient flexibility to make any necessary adjustments through regulation. This is not the time to amend this recently enacted law.

Given the complexities of ERISA, the lack of sufficient administrative personnel and the difficulties inherent in dual administration, it was inevitable that there would be numerous problems in implementing the legislation and getting its administration under way. But considerable progress in improving the law's administration has been made and most of the remaining problems can be handled by regulations. In short, amendments to the law are not essential at this time.

In addition, Congressional efforts to legislate extensive and far-reaching changes in the law could disrupt the understanding, acceptance and adjustments made by the many groups concerned with health, welfare and pension plans. Given the complexities of pension plans and the danger of hasty action, Congress only passed ERISA after years of careful study and consideration. Hasty action on a 285-page bill making a myriad number of changes in one of the most complex laws ever enacted will endanger the progress and stability that has been achieved and hamper further progress.

For these reasons, the AFL-CIO opposes ERISA legislation at this time.

Sincerely yours,

Ray Denison

Ray Denison, Director
Department of Legislation

c: Members of the Senate Labor & Human Resources Committee

STATEMENT
OF THE
NATIONAL AUTOMOBILE DEALERS AND ASSOCIATES RETIREMENT TRUST
TO THE
LABOR SUBCOMMITTEE
OF THE
LABOR AND HUMAN RESOURCES COMMITTEE

December 9, 1981

The National Automobile Dealers and Associates Retirement Trust (NADART) is a part of the National Automobile Dealers Association, a trade association representing 20,000 retail automobile dealers throughout the United States.

NADART is the sponsor/plan administrator of four Master Plans approved by the Internal Revenue Service. Members of the National Automobile Dealers Association may adopt one or more of the Master Plans sponsored by NADART. Currently, NADART administers over 5,000 small employer retirement plans, covering in excess of 70,000 employee participants and $450 million in assets.

We applaud your introduction of S1541 and your efforts to reform ERISA. We are encouraged by the enlightened approach that you have taken in recognizing that many areas of the original ERISA legislation have been made considerably more burdensome by subsequent regulation.

We have particular concerns with certain aspects of the bill, such as Title VI and the changes that have been proposed for single employer plan termination insurance. Available statistics indicate that small business pension plans are not a problem for PBGC and do not present any potential problem for abuse under the present Title IV provisions of ERISA. We recognize some of the concerns that large business has articulated, however, a close look at the history of ERISA and plan terminations will show that small business pension plans are not a burden on the system and, in fact, have created very little in the way of liability. In the largest year of plan terminations, 1978, there were a total of 15 plans that terminated insufficient. Nine of them subsequently became a drain on the system, that is could not make up the entire insufficiency, but did make up a part of it. The total liability upon PBGC was only slightly in excess of $200,000. It is obvious that the 30% of net worth rule is working well with regard to small business and a change is not necessary under the present rules with regard to such plans.

If these proposed rules are implemented there is no way that we could conscientiously recommend to our member dealers that they establish a defined benefit pension plan. Nor could we recommend that they continue to maintain such plans. Our dealers are still upset about the fact that when ERISA came along in 1974 it substantially changed the rules they were operating under at that time by imposing a 30% of net worth liability. Private plans are a voluntary fringe benefit on the part of employers, dictated by market conditions and competition for employment. Expansion of employer liability and changing of rules while the game is still in progress are serious deterrents to the long term viability of such programs. Imposing a 15 year contingency provision on small businessmen, who are forced to sell their businesses for one reason or another, makes it impossible for them to live with such plans. Placing PBGC as a general creditor will severely impair borrowing by small businessmen. Unacceptable loan conditions will be added to agreements, rates of borrowing will be increased, amounts of money that can be borrowed will be decreased and the ultimate placing of such liabilities upon the employer's balance sheet will begin to bring things to the attention of lenders to small business that they are totally unaware of at present. When the first case occurs in which PBGC makes a claim on an employer and lenders get less than they expected the news will spread like wild fire.

We recommend that the rules for small business remain in effect as they are now. With respect to Title IV and protection for PBGC, such things as a phase in of benefit increases over ten years rather than five should be considered. We also recommend freezing the maximum guarantee. There is no compelling reason for it to continue to escalate. We recognize that there are potential problems but these potentials are even greater if these proposed changes go into effect.

Changing an employer's liability from 30% of his net worth to a requirement that he continue to fund over 15 years the vested accrued benefits increases his liability since the vested may well be more than the guaranteed benefits under Title IV.

While PBGC says the potential losses to the system equal $3.8 billion dollars, such losses are not immediate since the system is not an insurance system that has immediate outgo, rather it is a pay-as-you-go system, and in the case of Chrysler, for example, while there are a billion dollars in liabilities there are plan assets. The Chrysler plan would not become a drag on the system as a result for a number of years.

Small plans are better funded plans. Few of them are insufficient. There are very few small plans that would ever begin to approach the unfunded status of larger plans.

With regard to the issue of an incentive to dump a plan, companies do not make decisions with regard to their pension plans as if they were in a vacuum. They will not see competitors dumping plans and do likewise. There are many other factors that enter into taking such a step.

PBGC's cash flow is positive at the present time. Granted it may not always remain so, but there is no reason why employers have to be forced to pay today for possibilities that may occur in the future.

With regard to encouraging employers to terminate only adequately funded plans, we suggest that consideration be given to creating a tax deduction in cases where an employer simply must terminate a plan immediately. Allow him to fully deduct all contributions that must be contributed in order to bring the plan sufficient.

The PBGC general creditor claim problem is a substantial one to the small businessman. Right now he deals with less sophisticated lenders and small town banks. Any growth of unfunded liabilities affects the creditor so he will attempt to limit plan benefits. Thus, we have the creditor involved in management decisions. In addition, it may be totally out of the hands of the employer when conditions occur under his pension plan that would adversely effect his loan agreements, which the lender may have placed conditions upon.

While there should be no differences at present in how a lender takes into account pension liabilities, the fact remains that there is. Of course, the bigger banks in Los Angeles, San Francisco, Chicago and New York recognize such potential liabilities even though they don't appear on the balance sheet, but smaller lenders don't. They have very basic formulas that they apply to balance sheets and income and loss statements to determine whether a company is credit worthy.

With regard to the 35 participant rule and exempting such plans from premiums, any exemption should also include exemption from the guaranteed benefits of Title IV. An employer should not receive guaranteed benefits and not pay premiums. However, we do not believe that the 35 participant rule is fair or adequate in light of the previous discussions and arguments that we have made.

Employers are going to tend to take the path of least resistance. The more difficult the Congress, the Administration, and the entire pension system make it upon an employer to establish this type of plan the more plans will be terminated. An employer simply does not need the aggravation, especially when he can provide a defined contribution plan or some sort of a thrift and profit sharing plan.

With regard to other specific provisions of the bill, we approve the changes in the Summary Annual Report, however, we encourage you to push for elimination of the Summary Annual Report. This document is of virtually no use to an employee in determining the financial health or status of his plan nor his benefit.

We support the change in the use of the Notice to Interested Parties, but again we urge elimination of this form. Of the over 500,000 NIPs filed since ERISA there has not been one case on record of IRS changing its opinion as a result of the comment. The form delays approval in obtaining determination letters and it is a particular problem with respect to plan terminations holding up of benefits to participants.

With regard to Section 3309 on Joint and Survivor Annuity Requirements, the amendment provides that the qualified joint and survivor annuity provisions are to be applicable to disability benefits. Where the disability benefit is the unreduced accrued benefit, the amount payable to the spouse should not be greater than what would be payable had the participant retired for early retirement and received an actuarially reduced benefit. The disabled participant is being given a full accrued benefit as if he had retired at normal retirement date. The spouse should not benefit doubly.

With regard to Section 3305, we support this change, it is an excellent change in the return to an arms length rule, however, it looks like a conforming amendment is needed to Section 4975(c) of the Code.

With regard to Section 4501, we support this but why not pick up all of ERISA 403(c) since this section, as written, only picks up the mistake of fact types of contributions as available for refunds.

Regarding Section 4802, we believe that an addition is needed to the bill to amend Code Section 402(e)(4)(B), which presently creates a problem on multiple distributions when a distribution from one plan is used as a roll-over and the distribution from the second plan is one which an employee wishes to use ten year averaging for. Under present rules he would be prohibited from doing that since ten year averaging has to be elected with respect to all distributions.

Regarding Section 4805, we recommend elimination of this provision because it presents distribution problems with regard to after tax dollars under the present 408 provisions. Mixing of non-taxable contributions by employees with taxable contributions to the employee made by an employer creates problems.

Regarding vesting in 4810, we support this change and in addition we request that the word "or" be added between Sections (i) and (ii).

We oppose changes to the integration provisions enumerated in Section 4811. We do not believe that integration changes are necessary at this time, nor prudent, because of the upheaval presently taking place in the Social Security system and the debate that is continuing. Until such time as those issues are resolved we believe that no changes in integration should be made, and, in fact, a rather detailed study and analysis of such changes is necessary before any action is taken.

With regard to Title VI and a specific problem, Section 6117, page 253 of the bill, item B-(2), appears to provide for the employer to pay the expenses of PBGC with regard to the plan termination. This is a substantial change from the present rules. We recogonize this may be an attempt to hold down premium increases of PBGC as a result of expenses. Clearly, employers would not have to want to pay the expenses of PBGC out of their plan assets, making their insufficiency even greater.

We appreciate this opportunity to present our comments and will be happy to provide any additional information you feel would be helpful.

Senator NICKLES. The meeting is adjourned. Thank you.

[Whereupon, at 1:12 p.m, the subcommittee adjourned, subject to the call of the Chair.]

RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE SIMPLIFICATION ACT OF 1981

TUESDAY, JANUARY 26, 1982

U.S. Senate,
Subcommittee on Labor of the
Committee on Labor and Human Resources,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:38 a.m., in room 4232, Dirksen Senate Office Building, Senator Don Nickles (chairman of the subcommittee) presiding.

Present: Senators Nickles, Hatch, and Quayle.

Senator Nickles. Good morning.

Today is the fourth day of hearings on Senate bill 1541, the Retirement Income Incentives and Administrative Simplification Act of 1981.

Today we are considering only the amendment to fiduciary responsibilities of Senate bill 1541. We will be discussing Senate bill 1678, by Senator Hatch, which proposes other amendments also with regard to mortgage investments.

As you may be aware, this Thursday, January 28, the subcommittee will be holding hearings on Senate bill 1785, the Labor Management Racketering Act. Standards for those who actually deal with the assets of pension plans will be discussed, along with other issues.

No other provisions of ERISA draw as much attention as the prohibited transaction rules. Problems under the Multiemployer Act of 1980 certainly share this limelight, and will be discussed before this subcommittee on March 11 and also March 17.

Today, however, we will be focusing our attention on the prohibited transaction rules of S. 1541 and also Senate bill 1678. I do not know that either of these particular pieces of legislation are ideal or complete, but certainly they do offer us the focal point to begin discussions.

We are very appreciative today to have Secretary Donovan to shed some limelight on what the Department of Labor has been doing, and will continue to do as far as compliance and the administration of the prohibited transaction sections of ERISA.

It is my hope that we will be able to forge with the administration and make some of the needed changes concerning the prohibitive transaction rules to protect and insure that the funds are used and will be used and invested properly.

Senator Hatch, as chairman of the Labor Committee, we certainly welcome your input with the legislation, and your expertise in this area, and we are glad to have you with us this morning for any comments that you might make.

Senator **Hatch**. Thank you, Senator Nickles.

I am exceedingly pleased that my distinguished colleague, Senator Nickles, has scheduled this hearing today. As he has indicated, we are especially interested in ERISA's prohibited transaction rules, which govern dealings between pension funds and related parties. In enacting these rules in 1974, Congress arguably struck a harsh balance. Persuaded that it was difficult to police these transactions, Congress generally prohibited most such dealings even if the transaction was fair and at arm's length. Relief from these rules—both on a case-by-case basis and a classwide basis—was to be afforded by an administrative exemption procedure.

Unfortunately, experience since 1974 has raised serious questions over the efficacy of these rules. There has been an increasingly loud chorus of complaints over the capacity of the enforcing agencies to administer the rules, and particularly the exemption procedure, in an expeditious manner. Repeatedly, we hear that the administrative process is burdensome, costly, and fraught with delays.

No one of course can quarrel with the purpose of the prohibited transaction rules, which is ultimately to protect and secure the benefits of retirees. But that purpose is ill-served by rules which rob pension plans of legitimate investment opportunities, yielding adequate and secure returns.

It has been particularly troubling to me that current law and its administration has frustrated what appear to be tremendous investment opportunities in the housing market. It is no secret that the housing industry is suffering its worst economic downturn in 40 years. We frankly have a crisis on our hands. And one of the ways that this situation can be turned around is to facilitate a massive infusion of capital into the housing market. Already many State and local governmental pension funds, which are not subject to the strictures of ERISA, have taken advantage of this investment demand. One news article noted recently that the "rapid, recent growth in city and State pension fund activity in home mortgages is probably the best kept multibillion dollar secret in real estate." In at least 20 States, public pension funds have stepped up investments in mortgages or helped to create new financing vehicles to assist housing construction.

In contrast to public pensions, the private pension system has been slow to invest in housing mortgages. And I believe part of the problem may be the barriers now posed by ERISA, particularly the prohibited transaction rules and the so-called prudent man rule. For this reason, I have introduced S. 1678, which is intended to lower these barriers without sacrificing the security of pension plan assets.

I am particularly grateful that Senator Nickles has scheduled witnesses today who will address this extremely important issue in the broader context of omnibus ERISA reform bill, S. 1541. I cannot reiterate too often how proud I am to have both Senator Nickles and Senator Quayle on this particular committee, as well as our other Senators, and have Senator Nickles chairing the Labor Subcommittee. He has demonstrated decisive leadership in pursuing review and reform of our critical labor laws. And he is to be highly commended. It is not an easy job. It is a controversial one, and it takes a lot of guts to do, and I really appreciate it.

I should also like to take the opportunity, when he arrives, to welcome my distinguished colleague, Senator Lugar. He serves as chairman of the Housing and Urban Affairs Subcommittee of the Banking Committee. And, of course, he is as concerned as I am over the problems facing the housing industry.

In particular, I want to welcome my friend Secretary Donovan of the Department of Labor. Under his leadership, the Department this past year has vigorously carried out President Reagan's mandate of regulatory reform.

I think, Mr. Secretary, you have made some good and proud strides in this area, and I want to compliment you personally for it. We have witnessed this in a wide variety of areas, including pension regulations.

The three gentlemen who are with you, I think have worked very well with this committee, have done everything they possibly could to help us to understand the problems, and understand the issues, and how to resolve the problems in a manner that might be compatible with what your goals and desires really are.

So we are very pleased to have you review for us the Department's assessment of current law and the proposed legislation.

I might also add that we realize that you have tried to use this exemption procedure, and we think you are moving in the right direction, and we appreciate what you have tried to do there. So we are grateful to have you here today, and we are grateful for each of your associates who is with you today, as well.

Thank you, Mr. Chairman.

Senator **Nickles**. Thank you, Senator Hatch. We appreciate your comments, and also your compliments.

Senator Quayle?

Senator **Quayle**. Well, thank you, Mr. Chairman.

I would just like to reinforce what Senator Hatch has already said, and commend you for holding these hearings. It certainly is an idea that is well worth taking a good look at to see if we can give some assistance to the housing industry.

I also want to pay my deep respects and compliments to the chairman of the committee, Senator Hatch, for his legislation, and to my colleague, Senator Lugar, who is the original cosponsor of this bill. I know both of them are keenly concerned about the housing industry.

There is no doubt about it, that we are in almost a depression state in some areas of the housing industry. We have the lowest starts in 1981, since 1946. It is my understanding that the total amount of pension plans have risen from about $38 billion to $600 billion in the last 20 years. It is expected to grow to $1.3 trillion by the mideighties.

Now, that is an enormous sum of money, and this legislation is just basically trying to facilitate a way to have a greater investment by those pension funds in the housing and mortgage markets.

So I certainly commend the authors of the legislation, and the chairman for conducting these hearings. Perhaps we will have some enlightenment from our witnesses on which direction we should pursue, but let us say that the goal is to allow more flexibility, to try to allow some of those funds being used for the housing industry. So I commend all of those who have been involved in this issue, Mr. Chairman.

Senator HATCH. I could say one other thing, and I appreciate the comments of Senator Quayle.

The reason we filed S. 1678 is because it really is for the purpose of trying to get more moneys into the residential housing market. I look at the homebuilding industry in this country, and residential housing, mortgage industry in this country, as really one of the most important for the resuscitation of our economy.

For instance, if we can get housing going again, and the only way it seems to me to do that is to get reasonable mortgage rates, we will be able to augment all kinds of support industries all over this country. If the housing industry is going, people are going to be buying cars, the auto industry is going to go; if that goes, the steel industry goes, the plastics industry goes, the semiconductor industry, somewhat, the electronics industry. You have all the related industries in building houses and residential buildings, and frankly, I think that we have to take some very good approaches, and S. 1678, it seems to me, is one that is long overdue, and these artificial barriers to using pension funds, to create jobs, while at the same time probably giving the most secure investment opportunities, I think, is long overdue.

Again, we are happy to welcome you, Mr. Secretary, and your associates.

Senator NICKLES. Mr. Secretary, would you care to introduce your colleagues, and make a few remarks?

STATEMENTS OF HON. RAYMOND J. DONOVAN, SECRETARY, DEPARTMENT OF LABOR, ACCOMPANIED BY T. TIMOTHY RYAN, SOLICITOR; DONALD L. DOTSON, ASSISTANT SECRETARY FOR LABOR-MANAGEMENT SERVICES ADMINISTRATION; AND JEFFREY CLAYTON, ADMINISTRATOR, PENSION BENEFIT GUARANTY CORPORATION

Secretary DONOVAN. Yes, Mr. Chairman, and members of the subcommittee, I brought with me today Mr. Tim Ryan, Solicitor of Labor, on my left; Assistant Secretary Donald Dotson, on my far right; and the administrator for the pension and welfare benefits program, Jeffrey Clayton.

I appreciate, Senator Hatch, your comments about my staff. I share your high praise for them.

I am happy to appear before you today to discuss S. 1541, the Retirement Income Incentives and Administrative Simplification Act of 1981. I will address shortly the bill's fiduciary provisions which are the topic of today's hearings. It is first necessary, however, to discuss our commitment to strongly enforcing the Employee Retirement Income Security Act, ERISA, and our belief that it can and should be deregulated without hurting our enforcement effort.

We take no responsibility more seriously than our obligation to protect the retirement and welfare benefits of the American worker, and our efforts are aimed at safeguarding those protections in the most effective and efficient manner possible.

For many years before ERISA was enacted, the Labor Department and the Congress were inundated with horror stories from workers who, after long years of employment, were faced with inadequate—or no—retirement income despite the fact that they had participated in pension programs for years. Typical examples involved employees who resigned or were discharged only to find that they were entitled to nothing because they had left their jobs prior to retirement age. Other workers with as much as 40 years of service found themselves ineligible for benefits because the continuity of their service or participation in a plan had been broken. Inadequate contributions to a plan and plant shutdowns deprived others of benefits. In still other instances, employers and pension funds went bankrupt. In addition, prior to ERISA there were many serious abuses by trustees of employee benefit funds. These abuses resulted in participants and beneficiaries not receiving benefits to which they were entitled.

As evidenced by the examples just noted, there were two main problems. The first was the loss of pension benefits despite substantial years of service, and the second concerned the financial security of the plans.

Recognizing the need to bring together and improve hundreds of years of trust law and to establish basic rights for participants and beneficiaries and minimum standards for plans, the Congress in 1974 enacted ERISA. The Department of Labor was given important enforcement responsibility under the new law to insure that participants and their beneficiaries were protected.

This administration will not waiver from its urgent responsibility to enforce this law fairly and effectively. We undertake this responsibility with determination and commitment. It is our solemn obligation to safeguard the pensions of some 50 million workers in 560,000 pension plans, and, perhaps, three times that number of workers and beneficiaries in the 4½ million welfare plans in the United States. Our responsibility is made even more awesome by the estimate that pension plans will balloon from a present value of $560 billion to a figure almost sixfold of $3 trillion—I repeat, $3 trillion—in 1995, only a mere 13 years from now. In enforcing this law, we know that the actions we take today will have extremely important ramifications for the future lives and well-being of large numbers of Americans.

I want to also emphasize that we intend to enforce vigorously the mandate of the law that the fiduciaries of funds act solely in the interests of the participants and beneficiaries. We will not allow increased risk or decreased returns by so-called social investments—even those which may have the noblest of purposes. Plan assets must be protected fully.

We are constantly reviewing the ERISA program so that we can reverse any past mistakes and make improvements for the future. In enforcing this law, we are committed to the elimination of needless paperwork and other burdens on the public. At the same time, we must be sure that no actions we take will reduce needed protections. We believe that our approach of eliminating needless burdens will allow us to place our emphasis on the most effective enforcement possible.

Mr. Chairman, with that background in mind, let me turn to the primary portion of my testimony which will:

Review a number of regulatory actions we have undertaken to improve ERISA;

Outline our position on the fiduciary sections of pending legislation; and

Discuss other actions we have undertaken to improve our enforcement and administration of the ERISA program.

One of the two areas of ERISA for which the Labor Department is primarily responsible is the reporting and disclosure provisions; the other is the fiduciary provisions. While the focus of these hearings is the fiduciary responsibility provisions of ERISA, I want to say a few preliminary words about the reporting and disclosure provisions.

S. 1541, the Retirement Income Incentives and Administrative Simplification Act of 1981, the subject of these hearings, provides for amendments to these provisions of the act. As you are aware, there are differences of opinion on the reporting and disclosure sections of the bill. I think that it is important that the changes in the single employer termination insurance provisions—which, as you know, the administration supports in an amended form—not be delayed by the debate over the reporting and disclosure changes. I believe it is important for there to be a full understanding and consensus concerning legislative changes in the reporting and disclosure provisions. Accordingly, I believe that it would be helpful for our staffs to work together to discuss the legislative options in this area.

I would emphasize, however, that the administration will be moving forward with needed administrative changes to improve ERISA. The Vice President's Task Force on Regulatory Reform is doing an excellent job analyzing regulations including those under ERISA to determine their effect on small businesses. In addition, the Department has an in-house task force which is in the process of reviewing all of the ERISA reporting and disclosure requirements. There are many changes that can be made administratively that will have the immediate impact of reducing ERISA's paperwork burden but will not jeopardize participants' rights or funds. Nor will they adversely affect our enforcement efforts.

Our immediate administrative efforts will focus on reanalyzing and completing several pending regulations. In addition, all existing regulations will be reviewed. We will be guided by the following criteria: Either the regulatory action will reduce unnecessary paperwork or will create greater certainty and flexibility in investment decisions, or it will not be pursued. With this in mind, we have already limited considerably the number of ERISA regulations that were previously under consideration by the Department.

Among the regulatory actions that should be completed is one that defers the due date for filing the updated summary plan description until at least November 1982 and another that would simplify the summary annual report (SAR) requirement for small plans.

With respect to reviews of existing regulations, we will probably look first at the summary annual report and the annual report. The annual report (also known as the form 5500 series) is, in essence, a statement filed with the Government describing the financial condition and transactions of the plan. The summary annual report, as the name indicates, summarizes the information contained on the annual report, but it is made available to plan participants and beneficiaries.

The summary annual report has been criticized as being useless and burdensome; others believe it is a useful tool for generating employee interest in their plan's activities. We intend to review the issue carefully to determine its usefulness.

The annual report also has been the source of much controversy. The Senate Permanent Subcommittee on Investigations has pointed out that additional financial information is needed in the annual report for adequate enforcement. Others, including members of this subcommittee, have urged us to eliminate information that we do not use. I believe these comments are consistent. Not only could we reduce needless burdens on the public; we could also focus our efforts on achieving effective enforcement. We are committed to making changes that will eliminate useless information and others which will add needed information. We and the Pension Benefit Guaranty Corporation intend to discuss a timetable for these changes with the Internal Revenue Service.

I would also like to note that we are reviewing two nonpaperwork regulations which are addressed in S. 1541. One describes the circumstances under which retirees can receive payments other than through pension plans, so-called supplemental pay plans. The other defines what is a "plan asset."

I believe that we can, and will, be able to eliminate many of the ERISA inefficiencies quickly by administrative changes. Other changes, however, may require legislation. Whichever route is necessary, we will be guided by the belief that simplified reporting and disclosure is totally consistent with, and can enhance, continued strong enforcement. We are committed to reducing any unnecessary burden of ERISA, but we will support no change that would jeopardize plan assets.

I would now like to turn to the main topic of today's hearing, ERISA's prohibited transactions provisions.

Mr. Chairman, as you are aware, the act describes in detail certain transactions into which a fiduciary to a pension plan may not enter without prior permission of the Department. For example, a fiduciary may not enter into a transaction if he knows or should know that it constitutes a sale of property or the lending of money between the fund and a so-called party-in-interest.

S. 1541 would change the prohibited transactions provisions by allowing such transactions if the plan receives the same amount of money it would if it were dealing with a party that had absolutely no relationship to the plan. The technical term for this is adequate consideration.

While we agree that in certain instances the reach of the ERISA prohibited transactions provision is too extensive, we also know that they have been of critical importance to us in enforcing the act. Any change must be carefully tailored to insure that it does not create any additional danger to plan assets. In our view, the broad sweeping change of replacing the existing prohibitions on certain transactions with an adequate-consideration standard would not be consistent with our attempts to eliminate pension plan abuse. While this approach is, on the surface, appealing because of its deregulation aspect, we do not believe it provides us with an enforceable standard.

Before ERISA was enacted, the adequate-consideration standard was followed. It was found to be an inadequate mechanism to protect plan assets, and it was for that reason that the Congress did not provide for it when drafting the act. We believe that the same problems which existed with the standard before enactment of ERISA would reoccur.

First, it is very difficult to discover these highly questionable transactions until after the fact, and therefore, prevention is practically impossible.

Second, once what appears to be a nonconforming transaction is discovered, it would be necessary for us to expend substantial resources to investigate and litigate the issue on an after-the-fact basis.

Under the present law, plans must obtain prior permission to engage in a transaction which would otherwise be prohibited. If a transaction is undertaken without this prior approval, the Department can obtain a court injunction to stop it. This method is much more efficient and cost effective and, we believe, provides a mechanism for adequate protection of assets.

I would also note that the Department considers many exemption requests where there is adequate consideration and that we frequently deny such requests because adequate consideration would not insure that the plan is adequately protected. Let me give you a typical example of the problem.

Assume that a plan, administered by a company whose president is a fiduciary to the plan, decides to invest in real estate. The father of the president is looking for a housing loan, and the president determines that the plan should lend money to the father at the prevailing interest rate with the house as security. Assume further that the loan meets the adequate-consideration standard, and that the father gets no better deal than he would if he were a complete stranger to the president. However, if the father encounters financial problems and cannot make his mortgage payments, I am not sure we could say that the president could objectively decide whether to foreclose on the father even if that were in the best interest of the plan and in keeping with the fiduciary responsibilities imposed by ERISA. We could not feel confident that the employer would act solely in the interest of the plan participants and beneficiaries.

Instead of the readoption of an adequate-consideration standard, we propose an alternative for dealing with the problems created by the prohibited transactions process which is consistent with our attempt to increase our vigilance against misuse of employee benefit plan assets. We believe that we can use the administrative class exemption process to allow transactions which do not endanger plan assets.

In enacting ERISA, the Congress recognized that there could be certain types of transactions which would fall under the prohibited transactions provisions, but which might be beneficial to plans and their participants and beneficiaries. The Congress, therefore, provided an "escape valve," if you will, that allows the Department, upon petition, to issue administrative exemptions permitting classes of transactions which are found, among other things, to be in the interest of the plan and its participants and beneficiaries. This procedure allows us the opportunity for ample review and consideration on a case-by-case basis.

We have issued some class exemptions in the past. For example, we recently proposed a class exemption that will, in essence, free many residential mortgage-related transactions from the category of prohibited transactions. We have received public comments on this proposal, some of which have urged that the exemption be broadened even further. We will consider these comments as soon as possible after the comment period closes on February 4.

We will be using the class exemption process even more in the future. I would like to announce today that we will propose a class exemption for funds that turn their assets over to qualified professional asset managers which are defined as banks, insurance companies, and registered investment advisors that meet certain strict financial conditions.

These professional managers frequently have difficulty in assuring that the plan is in compliance with ERISA. In addition, they are already regulated by either their respective State, a Federal banking agency, or the Securities and Exchange Commission. Further, the exemption will be limited to those managers who are independent. We, therefore, believe that their transactions would pose no danger to the assets of plans.

The proposed exemption has two parts. First, it would allow a plan, managed by a qualified plan asset manager, to deal with virtually all parties-in-interest except the manager himself or one likely to have the power to influence the manager. Second, it would allow the qualified manager to deal with the employer, but only for the provision of tangible goods and related services in the ordinary and necessary course of business. This will allow normal business transactions to occur without the necessity of requesting individual exemptions from the Department.

Let me give you an example of how the exemption would work. Assume that a qualified professional asset manager uses plan assets to buy a building which has an elevator serviced by the XYZ Co. If the plan wants to buy another elevator for the building, it could not presently do so from XYZ without first obtaining an exemption from the Department. The proposed class exemption would allow such a transaction, and it would also allow the asset manager to deal with XYZ if the company contributed to the plan as long as it was in the ordinary and necessary course of plan business.

As I previously mentioned, because the qualified professional asset managers would be independent of the employer, we do not believe that these transactions would pose any risk to the plan or increase the possibility of plan abuse. However, if the comments we receive indicate that we are mistaken, we will make any and all necessary changes. Similarly, if it can be shown that we can go further in the exemption without endangering plan assets, we will do that. Needless to say, we welcome this subcommittee's comments on our proposal.

I want to emphasize that we do not intend to extend the same flexibility of our proposal when qualified professional asset managers are not involved. When it is the plan sponsor who is determining where plan assets are to be spent and invested, there is a considerably greater risk of plan abuse.

On enforcement, Mr. Chairman, I wish to describe for you and the members of the subcommittee our new approaches in litigation strategy which I believe will strengthen still further our enforcement effort designed to protect pension and welfare plan participants and their beneficiaries. I would note that we are also totally reviewing our investigatory efforts, methods, and priorities. We will be implementing those changes necessary to assure that our total enforcement effort is as effective as possible.

In the past, it has been the practice of the Department to select a limited number of cases for litigation under ERISA based in substantial part upon what was seen to be the precedential value of these cases. For 5 years before 1981, the Department initiated only 67 cases. In fiscal year 1981, 31 cases were initiated by the Department as plaintiff and by the end of fiscal year 1981, there were 52 plaintiff-initiated cases pending.

As I have previously indicated, I believe it is critical that we greatly increase the effectiveness of our enforcement efforts.

I have decided to undertake the following new initiatives:

First, redirect litigation efforts toward enforcing the law, rather than making law;

Second, devote more of our existing resources to ERISA;

Third, decentralize ERISA's litigation in order to promote greater efficiency and effectiveness.

Mr. Chairman, I will discuss each of these important new initiatives individually. First, I believe that it is imperative that the Department's litigation efforts assume a more conventional mode of enforcement. Simply stated, I believe that the case files referred for litigation must be analyzed on their own merits and an appropriate decision must be made as to whether the cases should be pursued. We will not decline to pursue cases because they have limited precedential value.

Second, such an enforcement mode as I have just described will require us to devote more of our resources to ERISA because many more legal actions will be initiated in an effort to protect pension plan participants and their beneficiaries. In this regard, the legal staff dedicated to ERISA litigation will be expanded by close to 25 percent within present budgetary authority.

Finally, in an effort to utilize our resources in the most efficient way, we are establishing a pilot project in the Department's San Francisco regional solicitor's office to determine if ERISA litigation can be effectively decentralized. Under the terms of this experimental program, ERISA litigation will for the first time since the passage of the statute be handled in the field rather than in Washington. I believe these initiatives will be of immeasurable assistance in strengthening our hand to insure the integrity of the Nation's pension and welfare plans.

Mr. Chairman, I believe that this subcommittee and the Department share the same objective—to relieve the burden of ERISA without in any way endangering plan assets. The steps I have announced today will accomplish many of the objectives of S. 1541 in the reporting and disclosure and fiduciary areas.

In summary, we will be:

Issuing several regulations that are near completion and meet our criteria of reducing paperwork or creating greater certainty and flexibility in investment decisions;

Reviewing all reporting and disclosure regulations to assure that they are necessary for enforcement and impose the minimum burden;

Stopping work on many other regulatory projects until we determine if they meet our regulatory criteria;

Issuing a class exemption that will relieve plans that turn their assets over to qualified professional asset managers from most of the prohibited transaction rules;

Seeking other class exemptions that can relieve the burden of ERISA without endangering plans; and

Working with this subcommittee on S. 1541 to supplement and assist the above administrative steps.

Our chief responsibility is to insure that plan assets are protected. This places a tremendous obligation on us. There is considerable money and many peoples' futures at stake. We are committed to enforcing this law vigorously. I strongly believe that we can carry out that responsibility and at the same time reduce paperwork and other burdens.

In conclusion, Mr. Chairman, because ERISA is so very complex and far reaching, it will need responsible and pragmatic administration to make it work. I believe that, through your efforts and ours, ERISA will be made to work so that it will continue to serve its basic purpose of protecting and insuring the rights of participants, beneficiaries, and their families.

This concludes my prepared remarks. My staff and I would be happy to answer any questions you and the other members of the subcommittee may have.

Thank you very much.

Senator **Nickles**. Mr. Donovan, we appreciate your extensive homework, as evidenced by your very thoughtful statement. You made some mention of changes that I think will certainly be well received by many in this room, and by many of the pension managers throughout the country.

I think you, Mr. Clayton, Mr. Ryan, and Mr. Dotson have shown a great deal of balance and work on this legislation and I welcome the opportunity to continue to work in the cooperation with our staffs for making some of these changes.

I have several questions, and, Senator Hatch, I know you have several also. Would you like to begin?

Senator **Hatch**. I would be happy to.

Mr. Secretary, you indicated that the Department will be utilizing the administrative exemption process on a class basis, to facilitate transactions involving parties in interest. However, in reviewing the testimony of witnesses who will appear after you, I sense that the administrative exemption procedure has not worked effectively in the past, and I kind of indicated that in my opening remarks.

What assurances can you or your associates provide that in the future things will not be business as usual, with more undue costs, delays, and lost business opportunities?

Secretary DONOVAN. There is no question, Senator Hatch, that there have been inordinate delays in the past in reviewing individual class exemptions. I believe since January 20, of last year, we have made substantial strides. We recognize that logjam.

I will ask Jeff Clayton to give you the statistics on that. I believe we have now a turnaround of 5 months on some very complicated exemption requests, where in the past it exceeded 1 year, or maybe 18 months, but Jeff, would you——

Senator HATCH. Before you add to what the Secretary has said, let me just ask another question along the same line.

Has the Department given any review to my bill, S. 1678, which modifies the prudent man rule and prohibited transaction rules with respect to residential housing mortgages?

You could just answer both, and continue on with what the Secretary asked you to answer.

Mr. CLAYTON. With respect to the processing of exemptions, I think first there is the definite improvement over the years. In calendar year 1979, the average processing time per exemption was 16.7 months. In 1980 it was 7.6 months, and in 1981 it was 4.8 months, and those are overall averages. That is not the average just for calendar year 1981. That is 4.8 months, including the long ones that occurred prior to that.

So the processing time is dropping down.

Senator HATCH. That is a commendable record.

Mr. CLAYTON. Second, because we plan to issue some fairly broad class exemptions, I think the number of exemptions requested ought to drop, provided those class exemptions are issued.

Third, we have intentionally narrowed the scope of regulatory matters that we are working on in the Department, so that we can take the additional resources that we, for example, used on some 20-odd regulations, and take those same resources and put them into the exemption process.

We are now working on approximately 7 regulations as opposed to 20. We take those extra resources, put them in the exemption process, and therefore we have more resources to turn exemptions over even quicker. We recognize there have been unacceptable delays in the past, but we are committed to shortening the time, and I think we can do so.

With respect to your second question, on Senate bill 1678, we have analyzed and reviewed it, and I think there are some similarities between S. 1678 and the proposed residential housing class exemption.

We are certainly very much aware of the situation in residential housing, and the near crisis situation that does exist. The purpose of that class exemption which is still in the proposal stage, and which we are still listening to comments on, is to remove some of those burdens that you discussed, to make it easier for residential housing to be one of the types of investments that pension plans can make a decision to invest in.

We are not in the business of necessarily selecting out one type of investment over another, but in the past, pension funds were reluctant to make certain kinds of investments, because of legal impediments, and we want to remove those impediments.

With respect to the substance of your bill, the areas that I see perhaps need further looking at are, one; we have taken the position that your bill probably would allow, in some circumstances, residential mortgages to be made at below market rates.

Senator HATCH. That is true, as long as it is over a 10-year weighted average, or over 3 years, over the last 10 years.

Mr. CLAYTON. And that may or may not be below market.

Senator HATCH. However, it may be a very good investment in first mortgages for the pension plan to make, because these are long-term, solid, dependable secure investments, and that is what we are concerned about, and keep in mind, we are concerned about creating jobs in housing by getting those moneys out into the private sector, so that we can boost the housing industry, while at the same time, hopefully getting the high interest rates that people have to pay in this country by making some portion of this $600 billion in ERISA pension funds available for residential housing mortgages.

Whereas, as of today, they can be used for shopping centers, casinos, and all kinds of other opportunities, I suppose.

Mr. CLAYTON. Mr. Chairman, we agree with the object of allowing funds to flow to those types of investments. However, we are opposed to any system which, in essence, lessens the prudent man rule, which would be a system which allows below market rate loans. We think that in looking at the problem, perhaps allowing the below market loans would not be as helpful to the pension industry for this reason. With the exception of a limited number of plans whose sponsors have a vested interest in the housing industry, perhaps the carpenters, the other multiemployer plans that are related to the construction trades should be allowed to decide whether or not a plan will invest in a mortgage. That should depend basically on market factors, and if there are other investments with a higher yield, I think the market would actually respond to a below market rate mortgage, and the plan will not in fact purchase that mortgage. As you know, in the residential market, the source of funds is basically the secondary market, and by reducing those mortgage rates we may create a situation in the secondary market where pension plans would not be willing to buy a below market mortgage.

I think it would have a reverse impact. It would actually—it may create a situation where less funds would flow.

Senator HATCH. That may be, but we are not sure, are we?

Mr. CLAYTON. We are not sure, and that is a consideration.

There is another important difference between a class exemption and S. 1678. In the class exemption we require that the decision to make a mortgage commitment be made by an independent fiduciary. We do that for two reasons.

First, in many instances the commitment to make the loan may involve parties in interest. The person who receives the loan may be a member of the particular plan that is involved. The developer or the builder of the housing project may also be one of the employers that is covered by the plan. Because we have parties in interest, we think that that decision ought to be made by an independent fiduciary.

A second reason is that in discussing this matter with the people in the secondary market, we realized that the decision as to whether or not to purchase mortgage loans is a complex one, and most secondary market purchasers rely on the expertise of a fiduciary to decide which mortgages to purchase and which ones not to. Mortgages are complex, they vary from State to State, and real estate law varies from State to State. The added protection of having an independent fiduciary, hopefully one with some expertise, to review that mortgage, or package of mortgages, to be purchased, we think, is a good one. Those are probably the two main differences between our class exemption and your bill.

I should say, with respect to the class exemption, I anticipate that it will be broader when issued. When we proposed it, it was necessarily narrow, because it was in response to a very narrow request from a couple of specific industries.

Through the comment process, I anticipate that exemption will be broadened, will be more flexible, and will better meet the needs of the housing industry, than before.

Senator HATCH. How long do you think it will take before that exemption becomes a reality?

Mr. CLAYTON. The comment period closes on February 4. As a practical matter, we have to allow 10 days or so for the mail, to make sure that we have all the comments in. We may have to have a public hearing, and that would further delay it. If we do not, that might shorten it.

I think, though, in a matter of months after the close of the comment period, that the exemption should be out.

Senator HATCH. I see. Based on the profile of exemption requests decided in the past, what percentage of such requests would, in the future, fall under the proposed class exemption for professional asset managers, thus reducing the individual requests in the future?

Mr. CLAYTON. We do not have any statistics on that. We have discussed it with members of the industry, and actually, the relief granted by that exemption is probably broader than any exemption that has ever been proposed. Its effects should be quite dramatic, and it should very substantially reduce the number of applications particularly for individual class exemptions.

In fact, it is so broad that it actually overlaps some of the class exemptions that currently exist. So it should have a very salient effect.

Senator HATCH. Do you think that the broadening of the class exemption, as you have described it here, will be helpful or beneficial to the housing industry, and, of course, all the related support industries to the housing industry?

Mr. CLAYTON. I do not think there is any question about that. As you know, ERISA is a cost. It is a cost to any plan that has to comply with it. It is a cost to any manager who has to comply with it.

What we are doing is eliminating the nitpicking, technical burdensome things that make people irritated, and that costs a lot of money. But at the same time we are trying to draft that exemption carefully so that we are not eliminating necessary protections.

I think it will give some much needed relief, reduce costs, and reduce the paperwork burden.

Secretary DONOVAN. If I could add, Senator Hatch, Secretary Pierce, on February 24 and 25, has 2 days of meetings with the mortgage and homebuilders to explain this exemption. I think that will go a long way to help them understand it, and they are quite excited about it.

Senator HATCH. I hope you will push this exemption as quickly as possible. If it is broader than our bill, and will really open these for residential purposes, it seems to me that we have to have some methodology to get interest rates down. That is one reason that the bill was filed, because it will have a tendency to compete in the money markets, and I think while giving the best type of assurances to the fund managers, but be that as it may, I wish you a lot of success in getting this done as quickly as you can, and compliment you on trying to do so.

Senator QUAYLE. Will the Senator yield on that?

On the class exemption for mortgage investment, I understand that the proposed regulations go directly to single family dwellings, and not to the smaller multifamily units, is that correct?

Mr. CLAYTON. That is correct.

Senator QUAYLE. Is there any reason for that? It seems that the trend today is more toward the condominiums and co-ops, and if we are really seriously concerned about residential expansion, then it should not just be limited to the single-family-unit dwelling.

Mr. CLAYTON. The exemption process generally works by someone asking us to issue one. They would merely ask us for single family new residential housing.

We are looking for a broader definition of residential housing. We are also looking at the issue of whether it ought not just to apply to new housing, but to existing housing.

What we are trying to do with the exemption is have it fit the way the mortgage market works, and to accommodate as many of the parties, both banks, savings and loans, secondary market parties, as best we can, with the least amount of regulation.

I think, Senator, you will find that when the class exemption does go out we will have solved a lot of those problems of narrowness.

Senator QUAYLE. You do not see any major obstacle in expanding the class exemption to incorporate the multifamily unit?

Mr. CLAYTON. Well, I see—at first blush, I do not see any problem with expanding it to, you know, multifamily housing. Particularly in the sense that Freddie Mac and Ginnie Mae use it, condos, planned unit developments.

Senator HATCH. Can we count on you doing that?

Mr. CLAYTON. I think that is more than likely one of the provisions that will be changed.

Senator HATCH. You indicated that your present recommendation will be broadened.

Mr. CLAYTON. Right, that is our intention.

Senator **Quayle**. I would add my support to broaden that as much as possible.

Senator **Hatch**. So would I.

Senator **Quayle**. That is the trend. If we are going to talk about residential housing, it should be expansive and, to include these multifamily units.

Senator **Nickles**. I, would also, and the reason that I recognized Senator Hatch is because he has a meeting, and I know you wanted to address a question on this bill.

I would like to comment to you, Mr. Secretary, Mr. Clayton, Mr. Ryan, and Mr. Dotson, that I have been very pleased in monitoring this proposed class exemption which, hopefully, according to the timetable that you have given, would be implemented February 4 to February 14.

Mr. **Clayton**. Depending, under the Administrative Procedures Act, we are required to respond to those comments, analyze them, and in the preamble to handle those comments. We have 60 comments to date. Some of them are fairly complex.

I think within a matter of months, certainly hopefully within a matter of weeks, we ought to be in a position to have that formulated, to go out in final form.

Senator **Nickles**. I would certainly think that you would find a lot of support, and endeavor, with this committee, and also with the Congress, to expedite that as rapidly as possible.

Again, I would like to compliment you for your initiation of that. Senator Hatch, I can compliment you for your legislation, because I think, too, although I have not totally agreed with the amount and computation, that helps add some impetus for the regulatory reform that we are seeing in this class exemption. That is a move in the right direction, and also equally very important.

Mr. Clayton, I am pleased to hear your announcement today of the proposed class exemption for professional asset managers, banks, insurance companies, and professional investment managers. That exemption, as I see it, could be extremely broad.

Could you give us of a time schedule for trial as far as the proposed class exemption which you announced today? When could we look for that to be implemented?

Mr. **Clayton**. I think it is a very unique concept, and it is broad. We have not proposed it yet. There is a requirement that it go out, at least a 30-day comment period, which may or may not be extended, depending on what the industry requests. So we are talking about, first, we have to finalize the language, then it has to be proposed for a minimum of 30 days, and then we have to analyze the comments. So I think, realistically, in this area, we are talking about a number of months before it will be out and actually functioning.

Senator **Nickles**. I hope that you will be very cognizant of some of the testimony that will be coming up when we get into class exemptions, and the amount of time, and the amount of expense to process these exemptions.

I remember testimony in April, the figures of $25,000, and up to 2½ years. I hope something of this magnitude, and urgency will not cost that kind of money and that much time. I hope the Department, and certainly our committee and others will do basically what Secretary Donovan says, and work to insure that funds are not jeopardized in any way, shape, or form. At the same time, we need to work rapidly and as quickly as possible to eliminate many of the paperwork burdens.

Secretary Donovan, I understand that the pension programs have organized a paperwork reduction task force. What is the focus of the task force work, and when will that study be completed?

Secretary Donovan. We hope to finish the study very soon, certainly within the next month, but yes, there is a task force that we organized at the Department, and they are attempting to find the areas where ERISA is an unnecessary burden on employers.

With that, in fact, we are examining all of ERISA's reporting and disclosure requirements, to see what can be changed administratively, and which can be amended only through the legislative process. We will be using the task force study to set priorities for our examination of the regulations, and the paperwork rules to change, as well as to indicate the precise areas in which we would like to implement the changes.

It is a priority study, with our very best people, and as I say, I hope it is completed within weeks, no more than a month.

Senator Nickles. We look forward to receiving that, and working with you.

In your statement, you mentioned that among the regulatory actions which should be completed, one would defer the due date for filing the plan description until November of 1982, and another would simplify the annual report for small plans.

Can that be done administratively, or require legislative cooperation?

Mr. Clayton. The deferral date is imminent; that should be done administratively, and should be coming out at any time.

Senator Nickles. Is that a public announcement that has been made before by the Department?

Mr. Clayton. A proposal has to go out. The actual proposal should go to the Federal Register. I have not checked on it in a couple of days. It should be within days or weeks, that one is ready to go—this week, says the Solicitor.

Senator Nickles. Thank you.

Mr. Clayton. With respect to the SAR, the summary annual report, related to small plans, we have completed our analysis of that, and we can give major relief through the promulgation of that regulation administratively.

Again, that is a priority, and that one should be coming out in a matter of weeks, also.

Senator Nickles. Good. Will there be some changes in the annual report, and also the semiannual report?

Mr. Clayton. Yes, I think you are correct. That there are both administrative and legislative areas.

Senator Nickles. I know that our staff has worked with you, and certainly S. 1541 makes some initiative in that regard. However, I feel like we still have some work to do, as was brought about in the change that we had primarily on reporting disclosure. Certainly we wish to repeat our renewed interest in working with you as far as trying to come up with what Secretary Donovan alluded to, a simplified form, that at the same time may also have the information that would help the Permanent Subcommittee on Investigations, as they stated was needed.

Mr. Secretary, what type of goals do you have concerning the task force for enforcement on ERISA's?

Secretary **Donovan**. We have taken several steps to begin to improve our enforcement efforts, Mr. Chairman. We have established a task force, again, composed of representatives from the Office of the Inspector General and LMSA, which is analyzing the strengths and weaknesses, and we have both of the present enforcement programs, and we are recommending changes, recognizing the need for hard analysis and redirection of the enforcement program, we are very fortunate that the Department has the services as a consultant, of John Walsh.

Now, John who is heading this task force is an experienced investigator, with 17 years, with the Senate Permanent Senate Subcommittee on Investigations and 15 years with the FBI.

Among the issues the task force is discussing is the area of criminal versus civil investigations, and I would like at this stage to ask Tim Ryan to comment on this enforcement area.

Senator **Hatch**. Before you begin, Mr. Ryan, I want to personally compliment you and the Secretary, and of course, Mr. Clayton, for meeting with us last week and agreeing to work very closely with us on all of our investigations up here. We feel like we have really come to a point where we are starting to really understand some of the problems that do exist with the criminal elements, where even, shall we say, racketeering elements in some of these areas.

We are very appreciative of your personal work, and assurances to us, that you are going to help us in every way that you can.

And, I just wanted to personally let you know how appreciative I was to have that meeting last week.

Mr. **Ryan**. Thank you, Senator.

Before commenting on the Secretary's question, we would like to thank you for your assistance, Senator Hatch, and Senator Nickles.

The Labor Committee's oversight authority of ERISA, we believe, is a very, very important part of our entire program—of locking at the ERISA program, identifying the problem areas, and finding effective solutions, especially in the enforcement load. So we are encouraged by your oversight plans.

Senator **Hatch**. Thank you.

Mr. **Ryan**. As far as what we are doing in the enforcement area, hand-in-hand with Don Dotson and Jeff Clayton, we are trying to identify the areas where we can utilize our investigatory and legal staffs to the most important ends, that is, the protection of the plan participants.

The Secretary announced today that we are taking two major actions in this area. One is, we are increasing our legal staff in this area with basically a 25 percent increase. We are also initiating, starting March 1, a decentralized program to litigate and investigate cases in, I believe, the eight Western States, rather than centralizing all of them in Washington.

If this pilot project works, and I think we will know within the next 9 to 12 months, we will totally decentralize the ERISA investigatory and litigation aspects of the Department's process.

Senator HATCH. Mr. Ryan, how many total people would that add to your staff, 25 percent increase?

Mr. RYAN. It would mean a total of 255 lawyers, right off the top, which would be a significant increase.

Senator HATCH. It seems to me this shows a real commitment to get to the bottom of the awful things that are going on, that we know are going on.

Mr. RYAN. Senator, the important aspect of decentralizing the program is not only to afford the opportunity for all lawyers in the field to participate in this program, because obviously we have 107 other statutes that we are enforcing, so all of them cannot participate in ERISA. But it is to give this area the needed review that it yearns for in our estimation.

We feel very, very, very strong about moving this program from a precedent-setting arena into enforcement.

Senator HATCH. Let me just add something. I think that is a good step in the right direction.

One of the things that we are interested in in this committee, in our continuing investigations, and work with you, and the people down at the Department of Labor, is we are very interested in getting into just why there have been so many difficulties in this area, to the detriment of workers in America.

It seems to me our primary interest, and your primary interest ought to be a cooperative one, to try to protect the workers and their funds in America.

To be honest with you, I have not seen that kind of protection, nor have I seen any oversight in this area. We have just blithely gone on to allow some of these problems to just continue to exist, without any objective evaluation or investigation, or even consideration of the problems that the workers are facing, in losing the value of their plans, and sometimes losing their plans themselves, as some of them have been misappropriated, they have been misinvested, and of course, we have had many other problems in addition that we are starting to find out.

So, again, I want to thank you for your cooperation in this area, and we hope that we could have a long period of cooperation together.

Mr. RYAN. Senator, my colleague, Mr. Clayton, has brought one thing to my attention, just so that the record is clear about it.

The increase that we are proposing, which will take place within the next 2 or 3 months, will be an increase on the present litigation staff, that includes individuals who will be moved from other programs in Washington into the ERISA program in Washington, and the pilot project. If the pilot project works, and we can actually decentralize the program totally, then we will have the use of 250 plus lawyers.

Senator HATCH. Could I encourage you to maybe educate all of them as to the important work of this committee, and the cooperation that we are going to need in order to be able to—it is going to take a long period of time, years perhaps, but over a prolonged period of time, to be able to get into these matters, and to resolve them.

Mr. RYAN. We look for your assistance in that matter, sir.

Senator NICKLES. Mr. Secretary, when did 250 lawyers ever help a problem?

Senator HATCH. You can say whatever you want to that very unresponsive——

Secretary DONOVAN. I will reserve comment on that.

Senator NICKLES. Senator Quayle, do you have any additional comments?

Senator HATCH. It may be the most profound thing said today.

Senator QUAYLE. I just have one question.

I certainly appreciate the immense contributions that Chairman Nickles has made by introduction of his bill, and Senator Hatch and Senator Lugar and others.

I guess my question is, after listening to your testimony, do you think you can do this all administratively, or do you think eventually you are going to have to have some legislation?

Secretary DONOVAN. We believe so, Senator Quayle, yes.

Senator QUAYLE. That you will need some legislation, you cannot do this all administratively?

Secretary DONOVAN. We agree.

Senator QUAYLE. That is all I have.

Senator NICKLES. I will repeat our commitment to work with you and to help you with the administrative changes that we think would be beneficial.

We look forward to, and appreciate your cooperation, and initiatives in this area, as we continue toward the battle of protecting pensions, and eliminating unnecessary pensions.

We also look forward to your testimony on Thursday concerning Senate bill 1785.

Secretary DONOVAN. We look forward to it, too.

Senator NICKLES. Thank you, Mr. Secretary. Nice to see you here.

We are very pleased to have Senator Lugar, who has been waiting patiently in the wings, to offer his comments.

Welcome, Senator. I think Senator Quayle would like to address the senior Senator from Indiana.

Senator QUAYLE. I would just say that I have, unfortunately, a longstanding appointment at 11 o'clock in my office.

I have read your testimony, it is instructive, and insightful and I would just like to say "carry on," and this committee looks forward to working with you and your committee, to try to perpetuate a change that we all want to see, not only in our own great State of Indiana, but throughout the rest of the Nation, as well.

I think your dialog to get the ball rolling is excellent and on target.

Senator NICKLES. Thank you, Senator Quayle, for your comments.

Welcome, Senator Lugar.

STATEMENT OF HON. RICHARD G. LUGAR, A U.S. SENATOR FROM THE STATE OF INDIANA

Senator LUGAR. Mr. Chairman, Senator Quayle, I appreciate this opportunity to testify before the Labor Subcommittee today on the timely, and even critical, issue of revising ERISA so as to permit private pension funds to invest in residential real estate. Other witnesses will address the various technical and legal issues involved in this debate. I will refrain from this particular aspect of the hearing except to say that, as in most issues, there are a variety of ways to achieve the desired objective.

As you know, I am an original cosponsor of S. 1768, which has been introduced by the chairman of this committee, Senator Orrin Hatch. The approach taken in S. 1678 differs from that of S. 1541 which you, Mr. Chairman, have introduced on the broader subject of ERISA reform generally.

It must also be kept in mind that the administration is considering specific regulatory changes pursuant to existing law to permit certain types of residential real estate investments. We have had good news on that front.

The point I hope to leave most emphatically with the members of this subcommittee today is that rapid action on this issue is critical. Mortgages are a highly secure investment for pension funds to consider, and, in fact, have historically offered a higher rate of return than almost any other type of investment. I would like to submit for the record a chart prepared by Federal regulatory agencies comparing the interest rates and yields for various investments for the period 1970 to 1980. Both the security of the asset and the rate of return are fundamental considerations for any prudent pension fund manager. The data concerning residential mortgages should be convincing in this regard.

[The chart referred to above follows:]

SELECTED INTEREST RATES AND YIELDS, 1970-80

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1970-1980 Aver.	1975-1980 Aver.
6 Month T-Bill, Secondary mkt.	6.51%	4.52%	4.49%	7.20%	7.95%	6.11%	5.26%	5.53%	7.58%	10.06%	11.37%	6.96%	7.65%
12 Month T-Bill, Secondary mkt.	6.49	4.67	4.77	7.01	7.71	6.30	5.52	5.71	7.74	9.75	10.89	6.96	7.65
Moody Aaa	6.12	5.22	5.04	4.99	5.89	6.42	5.66	5.20	5.52	5.92	7.85	5.80	6.10
Moody Baa	6.75	5.89	5.60	5.49	6.53	7.62	7.49	6.12	6.27	6.73	9.01	6.68	7.21
20 Year Treasury Bonds	-	-	-	-	8.05	8.19	7.86	7.67	8.48	9.33	11.39	-	8.82
30 Year Treasury Bonds	-	-	-	-	-	-	-	-	8.49	9.29	11.30	-	-
Dividend/Price Ratio													
Preferred Stocks	7.22	6.75	7.27	7.23	8.23	8.38	7.97	7.60	8.25	9.07	10.57	8.05	8.64
Common Stocks	3.83	3.14	2.84	3.06	4.47	4.31	3.77	4.56	5.28	5.46	5.25	4.18	4.77
FNMA Auctions													
Government Underwritten Loans	9.00	7.82	7.64	8.33	9.31	9.26	8.99	8.73	9.71	11.50	14.15	9.49	10.39
Conventional Loans	-	-	7.82	8.53	9.43	9.37	9.11	9.05	10.01	11.77	14.43	-	10.62
FHLBB Effective Rate													
Newly Built Homes	8.45	7.74	7.60	7.96	8.93	9.02	9.00	9.01	9.54	10.77	12.65	9.15	10.00
Previously Occupied Homes	8.36	7.67	7.51	8.02	9.04	9.21	9.11	9.02	9.58	10.92	12.95	9.22	10.13
All Homes	8.38	7.69	7.53	8.00	9.00	9.16	9.08	9.02	9.56	10.87	12.86	9.20	10.09

Source: Federal Reserve Board. Federal National Mortgage Association. Federal Home Loan Bank Board

Senator LUGAR. Mr. Chairman, I need not remind anyone on this subcommittee, nor anyone in the Senate, about the plight of the housing industry in this country. This industry is in an irrefutable depression with little hope for immediate relief unless bold action is taken. Homebuilders, realtors, the thrift industry itself, not to mention the millions of Americans whose desires to enter the housing market have been all but eliminated, are all at a virtual dead halt.

The solution to this problem is complex. While high interest rates are largely to blame for this disastrous situation, a reduction of interest rates alone will not necessarily rescue the housing industry. What is fundamentally needed for revival of the housing industry is a new, plentiful source of mortgage finance funds. Pension funds offer the only such source.

The Congress must act immediately, to help bring this about. We have a responsibility in this matter, and to defer action on legislation in this regard would be irresponsible.

Congressional action to permit investment in residential mortgages would provide a permanent solution and the greatest possible assurance to pension fund managers. I believe it is far preferable to administrative action under current law.

Mr. Chairman, as a member of the Senate Banking, Housing, and Urban Affairs Committee, I am very much aware of the struggle to expand the lending powers of the Nation's thrift industry. Savings and loans seek broader asset powers in order to survive in the long run by diversifying their loan portfolios. Legislation to achieve this objective is pending before the Banking Committee and it makes ultimate sense from the thrift industry's perspective. What it does not do, however, is provide any assurance to the broader housing industry regarding housing finance in general. To the contrary, it makes homebuilders, realtors and many consumers very concerned about a stable source of finance for housing in future years. To permit pension funds, with their enormous resources, to invest in residential real estate, whether directly or through secondary market vehicles, would go a long way to bringing certainty to this situation.

I thank you for this opportunity to testify today and I would be pleased to respond to questions.

Senator NICKLES. Thank you very much, Senator Lugar, and we appreciate your interest, and also the interest of other members on the Banking Committee, because I think we all share the common goal of trying to see if we cannot make more funds available, in this case, pension funds, which have been stated to be in the enormous dollar figures, the $600 billion, and I think according to Secretary Donovan, by 1995 it will be $3 trillion, so we are talking about enormous amounts of money that in the past, due to ERISA and other requirements, have basically been excluded from the housing market.

So we wish to open that up, that a couple of legislative vehicles, and you mentioned, you felt were preferable to at least administrative changes under ERISA.

I am not sure how much of Secretary Donovan's statements that you heard, but they basically said, in hopefully the next few weeks that their proposal for class exemption which would allow exemptions on an arm's-length transaction, with no direct parties in interest involved in mortgages would be acceptable.

Does that—do you feel that that would encompass the majority of what we are really trying to get at, or do you think we need to even go a little further?

Senator Lugar. I am inclined to think that we need to go further, Mr. Chairman.

As you know, from your study of this issue, and the introduction of your bill, S. 1541, which goes a long way to provide a stable foundation, philosophically and legally for investment mortgages.

I suppose the difference I see between S. 1541 and S. 1678 is that S. 1541 still leaves a need to file for exemption and for a very considerable degree of review. Even if there is a broad philosophical bearing to uphold that.

Now, S. 1678, that Senator Hatch and I have introduced, really eliminates the prohibited-transaction restriction on mortgage investments, and it provides mortgage investments with literally a safe harbor from the prudent-man rule. It removes the risk of prohibited-transaction treatment for employee plan investments and home mortgages.

In other words, it specifically requires that an investment in these mortgages be authorized by the expressed terms of the plan, that normal commercial standards apply to the transaction and that the interest rates be charged be one of three alternative standards, to insure that the rate is adequate.

I think this is the liberalization that would be most desirable. Obviously, for homebuilders and for people who want to get into the residential mortgage situation, the time element that has been involved in review has proven to be prohibitive. The class exemption that the homebuilders first sought in the summer of 1980, which has been reviewed and delayed so many times, is an important example of how burdensome the administrative resolution process can be.

Senator Nickles. Certainly, even though it might not be the whole thing you would want, it would be a step in the right direction?

Senator Lugar. Of course.

Senator Nickles. We did not get a figure from the Department of Labor of how much that would open up; it is only for the market to dictate. I guess S. 1678 would be the safe-harbor rule from the prudent-man rule.

I have a reservation that investments granted on one or two of the options may have an interest rate due to past poor fund performance of—well, less than market performance. There has been a positive result with this legislation, and also with S. 1541, and hopefully it has helped encourage the Department of Labor to make those exemptions more readily available.

Senator Lugar. Mr. Chairman, if I could respond just a moment for the record to that particular comment.

S. 1678 says that the mortgage must have a reasonable rate of interest, and that is defined as the rate of interest equals or exceeds the average net yield of the plan for the preceding 10 years, or any successive 3 years therein.

I can understand why this has left some pause, as you have expressed, Mr. Chairman, and others have expressed. Although I suspect that this does insure that results going into the mortgage routes are going to provide returns that at least exceed whatever performance the plan has had before, that is an important floor.

Senator NICKLES. I appreciate that. I could not help but look at the funds that I have been involved with before, and have been involved in that fund, and having invested in long-term bonds, and watched the value of that fund deteriorate rapidly. I am not sure that we would be adequately providing a suitable rate of interest. That is the reservation I have.

Senator LUGAR. The point is well taken, and as we all now know what is prudent investment conduct in the past, namely going into a long-term bond, for example, might be characterized by some as imprudent, given the results, and that is the reason that I have submitted the chart, and some records as to why mortgage rates in our society are probably a better bet.

Senator NICKLES. We thank you very much for your expertise and input, and we will continue to work with you, and also the Banking Committee, to see if we cannot come up with a legislative direction to help accomplish our goals.

Senator LUGAR. Thank you, Mr. Chairman.

Senator NICKLES. Thank you.

Our next panel is the Small Business Council of America, Inc., Mr. Morton A. Harris, president, SBCA, Columbus, Ga., and also the ERISA Industry Committee, Scott J. Macey, who is from A.T. & T. in New Jersey.

Welcome, gentlemen.

Mr. Harris, would you care to proceed?

STATEMENTS OF MORTON A. HARRIS, PRESIDENT, SMALL BUSINESS COUNCIL OF AMERICA, INC., ACCOMPANIED BY HARRY V. LAMON, JR., OF THE LAW FIRM OF PAGE, SCRANTOM, HARRIS, McGLAMRY & CHAPMAN, COLUMBUS, GA.; SCOTT J. MACEY, AMERICAN TELEPHONE & TELEGRAPH CO., BASKING RIDGE, N.J., REPRESENTING THE ERISA INDUSTRY COMMITTEE, ACCOMPANIED BY GEORGE PANTOS OF THE LAW FIRM OF VEDDER, PRICE, KAUFMAN, KAMMHOLZ & DAY, WASHINGTON, D.C., A PANEL

Mr. HARRIS. Thank you. It is nice to be back again.

I am Morton A. Harris, and I am president of the Small Business Council; also a practicing attorney in Columbus, Ga., and have been involved in the pension field for over 20 years, and represent currently approximately about 100 qualified pension profit-sharing plans.

I would like to introduce, with me today, a past president of our organization, Harry Lamon, Jr., an attorney from Atlanta, Ga.; he served on the ERISA Committee from 1974 to 1979, shortly after ERISA was passed, was chairman of the Small Plans Impact Committee, and he is with us today.

The Small Business Council, just to take a moment, is a national organization. We have over 1,400 members, in 46 States, and we are primarily interested in Federal tax and employee benefit legislation.

Our organization consists of a very large advisory board of tax lawyers and plan administrators and business people who are interested in the field.

As an initial point, I would just like to reemphasize the point that the Small Business Council very strongly supports S. 1541 and its comparable bill in the House, H.R. 4330, and want to state that its purpose of improving the private pension system is totally consistent with the Small Business Council.

I would also like to mention, and emphasize, where Small Business is coming from, and I think to do so is important to look at the demographics, of pension and profit-sharing plans.

Secretary Donovan mentioned there were 565,000 plans in the country, and that there were 50 million covered participants. The study that was done several years ago indicated that there were over 500,000 at that point 4 years ago, and there has not been a significant increase in the number of plans, ERISA being partially accused for that phenomenon.

But out of these, approximately 70 percent, over 350,000, of those plans, are plans with under 25 participants—I am sorry, approximately 70 percent of the plans have less than 10 participants, and if you carry it to 25 participants, it will cover 90 percent, or over 450,000 of all the qualified plans have less than 25 participants.

I think to understand the dynamics of these small plans, and the way the provisions that are being discussed today impact on them, you have to understand the fact that these plans are put in primarily by decisions made by owner-employees, because of their own self interests. Certainly, they want to protect their employees, their own employees, however, the self-interest of themselves being a participant in those plans is most significant.

The reason this is important is that these prohibitions of preventing the plan sponsor and those in control of the plan sponsor from doing something untoward the pension plan just does not happen, because these plan sponsors have, as owner-employees, a very large participation in the plan itself. And so, if anything, they tend to try to benefit their plan, which is to their own self-interest, rather than trying to take advantage of it.

I guess the real impact of that point is that small business plans, those that have a significant owner-employee participation in that plan, have a wholly different base of concerns, and do not need prohibitive transactions to keep them from doing something that is going to be harmful to the participants in the plan. Because of that, I feel that the provisions of this bill are very significant in improving the administration of pension plans.

Let me delve then into the specific area of the bill to be covered at the hearing today, which is subtitle (e) of title III.

First, in subsection 3504, which relates to the fiduciary responsibilities, the Small Business Council is very much in favor of the proposal, which would allow a fiduciary responsibility, if they are prudently delegated, be delegated from the standpoint of the delegator not having any continuing responsibility. This is especially beneficial to the small business, because most of them, as you heard at prior hearings, must rely on outside administrators and other people to help, and must delegate, and not be able to relieve themselves of responsibilities—leaves them in a very awkward situation.

I think it makes a lot of sense, and would relieve a lot of liabilities, which are now being insured and indemnified, and everybody trying to be sure that they have all of their bases touched. It will make life a little bit simpler, and more reasonable, and certainly the key point is that the delegation be prudently done, and that is still in the bill. I think that without prudent delegation, there would be no protection, so that the delegation must be reviewed from time to time, as well as being thoughtfully done in the first place.

I would like to now turn to the prohibited transaction rules which are in the bill, 3505 through 3510. Basically, it calls for a return to the "arm's-length" standards for permissible transactions with a "party-in-interest." We strongly support this change, especially for small business.

The changes brought about by ERISA never were helpful to the small plans. The kinds of "horror stories," the term used by the Secretary, did not take place in small plans, and they do not take place in small plans because of the self-interest of the owner participant in the plan itself. It is very difficult for a person to try and take advantage of the plan when, in fact, he would be hurting himself. That is not always true, but it is almost always true.

However, because of the adequate consideration test, the prudent man rule, the diversification and the other requirements of ERISA, it would seem, at least in smaller plans, there would be no need for the prohibited transaction rules.

Well, what have the prohibitive transaction rules done that have been negative? From the standpoint of small plans these rules have created a situation where many worthwhile investments have not been made, even though there is an exemption procedure under ERISA, and even though it may be now taking only 4½ to 5 months, and even though there may be class exemptions, it is still something that small plans do not cope with well.

A decision needs to be made about whether or not to build a building for the plants, or the factory, or the office, or the store; and where to finance that building. Right now, you cannot, of course, use your plan funds for that. So you try to say, Why don't you apply for an exemption?

One of our business advisory board members, Robert Midkiff, who is president of the Trust Co. of Hawaii, and who personally does a lot of work in the pension and profits plan area—he is president of the Profit Sharing Research Foundation—has sent me a list of examples of exemption requests that have been made by relatively small businesses, many of which were approved. The point that is made is that the cost of every one of these exemption requests was in excess of $5,000.

Well, in many situations that does not sound like very much, but for a lot of small plans, that is too significant, aside from the time that it takes, and although 4 months does not sound like much in some situations, between the time and the costs involved, typically, you just do not go into transactions like that.

I think that it impacts indirectly on the desirability of pension and profit-sharing plans for small business in another way. If the plan sponsor cannot use these funds for its own building or plants, or expansion, or other types of legitimate needs, keeping in mind all of the other restrictions, and the limitations on using plan funds, then it is not as likely to want to commit very large sums of money to the plan, which it knows it can never have available to use. This has been one of the reasons, I think, as to why small companies are often less desirous of committing to new plans, or to expanding existing plans.

If the goal of your bill is to increase and strengthen the private pension system, I think that your proposal to go back to a fair consideration test would be very helpful, especially in the small plan area, to strengthen the whole pension area.

With those remarks, Senator, I would like to stop. Of course, I would be happy to answer any questions, as will my colleague, Harry McGlamry.

[The prepared statement of Mr. Harris follows:]

STATEMENT OF
MORTON A. HARRIS, ESQUIRE, PRESIDENT
SMALL BUSINESS COUNCIL OF AMERICA, INC.
AT HEARINGS ON S. 1541 BEFORE THE SUBCOMMITTEE ON LABOR OF THE COMMITTEE ON LABOR AND HUMAN RESOURCES
UNITED STATES SENATE, WASHINGTON, D.C.
JANUARY 26, 1982

Good Morning Mr. Chairman and Members of the Committee:

I am Morton A. Harris of the law firm of Page, Scrantom, Harris, McGlamry and Chapman of Columbus, Georgia. I am officially here today in my capacity as President of the Small Business Council of America, Inc. (SBCA). However, I am also appearing as an individual who has been involved in the private pension industry for over twenty years and who is vitally concerned with the continued viability and growth of a sound private pension system.

SBCA is a national organization of over 1,400 small business men and women located in 46 states. A major thrust of SBCA's efforts, since its founding in 1979, has been to identify problems in the small employer plan area and to seek solutions through the regulatory agencies or the Congress. SBCA's constant theme has been to urge the creation of incentives - and the elimination of disincentives - for the establishment and maintenance of private employee benefit plans by small business employers.

As an initial matter, I would like to re-emphasize the basic point I made when I testified before this Subcommittee last

November. SBCA strongly supports the thrust of S. 1541 and its companion in the House, H.R. 4330, introduced by Congressman John Erlenborn of Illinois. The stated purposes of this legislation - to encourage the establishment and growth of employee benefit plans and to encourage savings to meet the needs of employees and their families in the event of death, disability or retirement - are consistent with everything for which SBCA stands.

Mr. Chairman, in my view, the ERISA problems of small plans and small employers resulted, in no small measure, from the fact that ERISA was drafted with little consideration given to precisely how the reporting, disclosure, and administrative burdens - including the prohibited transaction provisions - would fall on small plans. I really cannot fault this Committee or others involved in drafting ERISA for this deficiency. Small businesses and small plans were relatively silent when ERISA went through the legislative process. The focus of the small business legislative effort was at the eleventh hour and was devoted to insuring that small plans could retain a sufficient tax advantage to encourage their continued growth and to insuring that there was no tax discrimination against small plans. In focusing on these problems, small business interests paid little attention to many of the administratives provisions of ERISA. I am delighted to note that since ERISA was enacted, small plans and small businesses, and indeed the entire private pension industry, have organized, and I can assure you that the small business sector will be outspoken when further employee benefits legislation is considered.

Over the coming months, SBCA will be communicating with this Committee, and with the House Education and Labor Committee, with respect to details of the pending bills. For today, I will confine my remarks to comments on some specific sections of Subtitle E of Title III of S. 1541 - "Amendments to Fiduciary Responsibility Provisions".

Section 3504

Section 3504 provides amendments relating to ERISA's co-fiduciary responsibility provisions. It makes clear that if fiduciary duties have been properly allocated, then a named fiduciary to whom a specific duty has not been allocated will not be held liable for an act or omission with respect to that duty by the named fiduciary to whom that duty has been allocated. We believe the changes incorporated in Section 3504 adopt what the Congress originally attempted to do when it dealt with the subject of co-fiduciary responsibility in ERISA. We believe named fiduciaries should be able to allocate duties, and to rely on such allocation for protection, absent knowing participation in another's action. The ability to allocate duties and to rely on such allocation is particularly important to small employers who often do not have the "in-house" resources to administer plans and manage plan assets. Such employers rely heavily on outside fiduciaries to handle such matters, and should be able to limit their potential liability by proper allocation of duties to other responsible fiduciaries.

Section 3505-3510

Sections 3505 through 3510 provide amendments relating to the prohibited transaction provisions of ERISA.

Section 3505 essentially provides for a return to the "adequate consideration" or "arms length" standard for permissible "party-in-interest" transactions. We strongly support this change. We believe that the current ERISA approach - which adopts a blanket, statutory presumption that "party-in-interest transactions are "bad", subject to their being proven "good" in a lengthy administrative procedure - is simply too stringent and costly for the resulting benefits to participants. Although some transactions which would not have been in the interest of participants or beneficiaries undoubtedly have been prevented under this approach, we believe that many more transactions, which would have benefited all concerned, have simply not been attempted. We recognize that much progress has been made since 1974 in granting needed exemptions and in refining the exemption process. However, the inherent costs and delays still preclude many small employers from entering into perfectly legitimate transactions which would be in the best interests of all concerned. Given that the "prudent man" and "exclusive benefit" rules will remain applicable to all investment decisions involving a plan, we would contend that so long as any transaction is "arms length" and for adequate consideration, it should be permitted. In taking this position, we are very mindful that under S. 1541, participants and beneficiaries will continue to have significant rights to comprehensive disclosure of plan activities and to causes of action for violation of the "prudence" and prohibited transaction rules. We are also mindful that the appropriate regulatory agency will retain its auditing and enforcement functions.

Section 3508 would amend ERISA Section 408 to provide specific statutory exemptions from the prohibited transaction provisions for certain common transactions involving "substantial employers". We support these exemptions. For example, the lease of property by a trust to an employer, under lease terms which are commercially competitive and where holding the property itself is "prudent", could be very beneficial to a plan and its participants as well as to the employer. Similarly, loans by a trust to an employer at "arms-length" interest and subject to adequate security could be beneficial to all parties concerned. Given the built-in safeguards of Section 3508, to require prior administrative approval of such transactions would involve a cost in terms of time and money which is simply not justified by the extra "benefit" to participants and beneficiaries.

Although we support Section 3508, we would suggest some additions. First, we would recommend a clear direction to the appropriate regulatory agency, preferably in the statute itself, that the exemptions contained in ERISA Section 408 are applicable to transactions described in ERISA Section 406(b) as well as Section 406(a). If the stated conditions for a statutory exemption are met, the exemption should be available regardless of whether the party-in-interest is also a fiduciary. Further, we would recommend a statutory direction in ERISA Section 408 confirming that a voluntary, non-deductible contribution of property other than money by a participant to a plan does not constitute a "sale or exchange" and, therefore, does not constitute a prohibited transaction. Individuals should be encouraged, not discouraged, to save for retirement, and often a voluntary contribution of property is more feasible than a cash contribution.

Section 3510 would extend the administrative exemption procedure to persons who are "owner-employees". We see no valid reason for the current provision in ERISA Section 408(d) which precludes "owner-employees" from availing themselves of the exemption procedure, and would submit that the preclusion was inadvertent when adopted. We strongly recommend the correction contained in Section 3510.

Mr. Chairman, that concludes my prepared remarks. I will be delighted to respond to any questions that you or the other members of the Committee may have.

Senator NICKLES. Thank you very much, Mr. Harris.

Mr. Macey?

Mr. MACEY. Thank you, and good morning, Mr. Chairman.

Despite your statement concerning the contribution of attorneys to the resolution of any problem, I will admit that I am an attorney with the American Telephone & Telegraph Co., in Basking Ridge, N.J., and I am here on behalf of the ERISA Industry Committee (ERIC), an association of some 100 major corporations concerned with national retirement policy issues. ERIC's members include half of the Nation's 50 largest industrial companies and represents a broad cross section of the Nation's largest retailers, utilities, banks and insurance carriers.

I am accompanied, on my right, by George Pantos, who is a member of the firm of Vedder, Price, Kaufmann, Kammholz & Day, here in Washington, D.C., which is counsel to the ERIC organization.

With that introduction, I would like to move on to the substance of our discussion here today, and before I do, express my appreciation personally and on behalf of ERIC for the opportunity to testify before the subcommittee. I am going to focus on essentially one major aspect of the proposed legislation, and that is the one dealing with prohibited transactions, even though the written testimony we have submitted does discuss and focus on several additional issues.

ERIC supports the general thrust of the proposed changes to the present ERISA prohibited transaction and fiduciary provisions as embodied in S. 1541. Although well intentioned, present ERISA prohibited transaction provisions have proven unnecessarily burdensome, restrictive, and costly to plan sponsors and fiduciaries to the detriment of plan participants and beneficiaries. In particular, plan sponsors are concerned with providng worthwhile and meaningful benefits to their employees in an efficient and responsible manner. Unfortunately, the complex requirements for technical compliance with the prohibited transaction provisions oftentimes have deprived plans of superior investment opportunities and have had the unintended result of depressing the potential value of pension and other employee benefit fund assets.

While the changes proposed in S. 1541 will be helpful in alleviating many of these problems, we believe they do not go far enough, and that additional modifications to the present prohibited transaction rules are necessary. Additionally, although it is possible to address many of these problems with new administrative rules, as we have seen the Department of Labor and Secretary Donovan propose, we believe that legislative amendments are needed in order to codify new rules and assure uniformity of application.

As an aside, I might commend the Department of Labor for the proposals announced here today, both those dealing with the class exemptions which were discussed, and also the increase in the enforcement responsibilities, because I personally believe that the way to cure abuses in the administration of pension plans and funds is through the enforcement responsibilities, rather than through the administrative rulemaking responsibilities dealing with the exemption process.

However, I still feel that there is a necessity to have legislation on this point, and that the resolutions cannot be found solely in the Labor Department actions announced today, and in other administrative actions. It is interesting to note that with respect to the Labor Department and Secretary Donovan's reference to prior laws, and I am not completely familiar with this, but apparently one of the provisions of prior law dealt with adequate consideration, which is an element of your proposed change to section 406(a).

I do not believe that the Department of Labor had the type of enforcement responsibilities under prior law, as they do under the current law, and additionally, I would suspect that the public in general, and plan fiduciaries in particular were not sensitized to the various fiduciary responsibilities that they now have, and have been sensitized after approximately 7 years under ERISA.

With respect to the particular class exemptions discussed here today, I probably am not in a position to comment on them in particular, not having seen them, and having just learned of them this morning. However, based upon what has been said, I am concerned in one respect that plan sponsors, especially large plan sponsors, who have developed a significant in-house expert force dealing with the administration of employee benefit plan assets, and have acquired a great deal of expertise and experience, which in some cases may match that of professional asset managers, would be excluded under the proposed class exemption, as I understand it.

With respect to 3505 of S. 1541, it would replace the absolute prior restraint feature of current ERISA party-in-interest prohibitions with a requirement that transactions between plans and parties-in-interest satisfy an arm's-length standard. ERIC believes this proposal is a step in the right direction because ERISA's present prohibited transaction rules have created serious problems in the management and administration of employee benefit plans. The absolute prohibitions in section 406(a) and the overly broad definition of party-in-interest (fiduciaries, employers, service providers, their affiliates and others) have had the adverse effect of barring many important transactions between a plan and a wide variety of parties-in-interest, really, to no avail, and to no purpose. In effect, the prohibition per se of all transactions and relationships falling under section 406—unless otherwise exempted—has resulted in an expansion of the Government role over the administration of private pension systems when the number of innocent and nonabusive transactions technically prohibited under section 406 probably far exceeds the number of those which have abusive potential.

Whatever the theoretical merits of the prior restraint approach and notwithstanding its possible effectiveness in other contexts, its unrestricted application to the investment of employee benefit plan assets has produced unfortunate consequences. These consequences are accurately and tellingly summarized in the explanatory statement to this legislation which notes that the ERISA hearing record is replete with examples of transactions involving parties in interest being prohibited to no purpose.

Indeed, it is clear that in most employee benefit plans of any size even the most routine transaction can run afoul of section 406(a). Moreover, as noted in the explanatory statement:

> The breadth of the prohibited group and the difficulty in identifying all parties-in-interest make it problematical whether any fiduciary of an employee benefit plan can really be certain he is not participating in a transaction violating Section 406(a).

In short, the practical impediments to complying with the section and its blind and senseless application in some cases simply make it unworkable.

Even the most common business transactions can run afoul of the section 406(a) rules. These deficiencies in the law are not just minor annoyances to fiduciaries and plan sponsors. Rather, as the sponsors of this legislation recognize, "these broad prohibitions (of section 406(a)), when applied to the commercial lifeblood of any employee benefit plan, impose an enormous burden on these plans." In particular, they preclude plans from entering into transactions which might well be advantageous to participants and beneficiaries.

Moreover, the section 408 exemption procedure has not provided sufficient flexibility to alleviate the deleterious consequences of section 406(a). The exemption process has proven to be slow and cumbersome.

Rather, the point is that the private employee benefit system is simply too large and too diverse to be subjected to the imposition of section 406(a) prior restraints with the expectation that an exemption procedure will be adequate and responsive enough to handle the needs of the system. In other words, it is the section 406(a) prior restraint concept itself which is flawed.

When combined with the broad language of section 404 of ERISA, and the equally broad responsibilities imposed by such section, the absolute prior restraint approach of section 406(a) represents a classic case of what has resulted in legislative overkill. Section 406(a) was intended to reinforce the safeguards in section 404 by prohibiting a fiduciary from causing a plan to engage in a broad range of transactions with any of a wide variety of individuals and businesses who meet the definition of a party in interest unless the transaction or the fiduciary is granted an exemption under section 408 by the Secretary of Labor or is otherwise exempt under the statute.

In effect, section 406(a) supplements section 404 which establishes the basic standards for a fiduciary's conduct. In particular, section 404 imposes the duties of prudence, care, skill, diligence, and undivided loyalty on all fiduciaries of employee benefit plans and requires them to adhere to the exclusive benefit and diversification rules. Also, inherent in section 404 are the fundamental standards of adequate consideration, adequate security and reasonable rates of interest. Given the intent and scope of section 404, section 406(a) only imposes onerous and unnecessary burdens on plans without any corresponding benefit in increased protection for plan participants and beneficiaries.

While we believe that section 3505 of S. 1541 is a step in the right direction, we feel it does not go nearly far enough because it fails to adequately correct the problem inherent in section 406(a) as it now stands. Our difficulty with the proposed amendment is not with what it seeks to accomplish. It is certainly a significant step in the right direction, but with the means by which it does so. Instead of changing the language of section 406(a), we urge that section 406(a)(1) (A) through (D) be eliminated because, as amended, it would still seem to be no more than an unnecessary and superfluous replication of section 404.

Now, I would just like to focus on one final point that is not addressed in the proposed legislation, 1541, that deals with section 406(b), which is a prohibition of various fiduciary transactions and focuses on some form of fiduciary self-dealing.

ERIC concurs that the provisions of ERISA section 406(b) prohibiting fiduciary self-dealing should be maintained. However, the current provisions of section 406(b), which focus on the conduct of parties in interest who are also fiduciaries, are unnecessarily burdensome and restrictive and should not apply when fiduciaries do not exercise or have the authority to exercise discretion in a particular transaction. In such limited circumstances, and I emphasize limited circumstances, fiduciaries are indistinguishable from other parties in interest who are not fiduciaries.

Given the broad ERISA definition of "fiduciary" and the uncertainty of any affinity among all of the fiduciaries for any plan, section 406(b) should be clarified to limit the imposition of fiduciary prohibitions to activities where the fiduciary exercises or has the right to exercise discretionary authority over the activities focused upon in section 406(b).

Significantly, the Department of Labor has issued regulations, an advisory opinion and an administrative exemption which would tend to support such an amendment to section 406(b) as we propose. We submit that from a policy standpoint, the thrust of these Department of Labor administrative actions should be incorporated into the act itself and be applicable to all fiduciary conduct in order to provide adequate protection and flexibility for fiduciaries and continue to assure the protection of participants and beneficiaries.

Thank you.

Senator NICKLES. Thank you very much.

A couple of brief questions, and it is regrettable, but we are going to have to move a little quicker than we have in the past if we are going to have a chance for everybody to be heard. All statements will be entered in the record as if read.

Mr. Harris and Mr. Macey, both of you concurred, and you alluded to it, that you feel like statutory changes ought to be made. In representing ERIC, which is the larger companies, with larger plans, and I can see you have a valid comment as far as having inhouse expertise may not be qualified as that word independent investment, professional manager. I think the word independent was used two or three times.

We have not chewed on that enough to see how that would come out, but assuming you would fall, or most of ERIC's group would fall under the so-called professional manager class exemption, as it was announced, would that pretty well satisfy your groups' desires, if you had automatic qualification under the class exemption?

Mr. MACEY. It is somewhat difficult to comment on your question, because we have not seen what the Department's proposal is, but assuming that they propose a class exemption which would exempt all those transactions which do not involve inherent conflicts from either 406(a) or 406(b), that were handled through a bank, insurance company or professional asset manager, it takes care of a good deal of the problem.

However, I would like to raise several points concerning this matter. First, an exemption given can be taken away. Second, if the Department of Labor is of the opinion that this is a step in the right direction, which I believe it is, then I see no reason not to institutionalize and codify it under legislation.

I feel that, and as you referred to, at least large employer plan sponsors, who have developed an expertise inhouse, should fall within the announced exemption, at least if one condition is met, and that is if the assets are held by a bank trustee. Such a bank trustee, at least under current law, and I assume under the changes suggested in 1541, would have some form of cofiduciary responsibility to ascertain or some knowledge as to whether or not the assets were being invested in a prudent and responsible fashion, even though it was a directed account, under which the bank trustee was directed to invest in certain ways.

I do not believe that a bank trustee would follow the investment directions if they had any question that the assets were not being invested in a responsible fashion. I personally believe, to try to get to the heart of your question, that it would be better to have legislation on this point, and legislation that covered the various aspects which I have discussed, and which did not draw any significant distinctions between the investments that were handled through outside professional asset managers, or those that were handled through bank trustees who were directed to make certain investments by inhouse fiduciaries.

Senator NICKLES. Mr. Harris, a question. I appreciate again your input on this legislation, and representing primarily the smaller plans, as you so eloquently stated, the number and size, the majority of plans being the smaller plans.

Most small plans have 10 or fewer, or 15 or 25 participants. Usually in that case I think you are talking about the boss makes most of the decisions, he happens to be the fiduciary of the plan, and trustee and owner of the company, and wearing several different hats, and a great many of those cases, do they just turn those funds over to an investment company, insurance company, a bank, and put the money in turn over to them, or do they turn around and invest it themselves, as they see fit?

Mr. HARRIS. There is a great variety among small plans. Many do turn it over to a bank, simply because the banks are able to provide administrative services that go along with investment services. But as has been the case during the past 3 or 4 years, there has been increased sensitivity about investment performance, and there have been efforts made to go outside.

Investment managers often have charges where plans below a certain level of asset value, you cannot afford a qualified investment manager. So many of them direct their own investments, even though they may have a bank trustee.

So the class exemption that was proposed would not be meaningful for an awful large number of plans.

Senator NICKLES. Particularly the smaller ones that did not have that size assets to qualify?

Mr. HARRIS. The minimum fee for an asset manager, they will often set fees of $1 million or above. But in a lot of these cases they will pay $100,000.

Senator NICKLES. They would not want to pay a 2-percent investment fee, or may not be able to qualify for that type any how, so they would invest it in Treasury bills or bonds, whatever they can?

Mr. HARRIS. Then, as you know, a business person, very astute investors, they tend to outperform banks, and they just do a wonderful job for their plan.

Senator NICKLES. Some of us have tried, and not been successful.

Mr. HARRIS. But that has been, as I say, it is a mixed bag, and there are few that go to qualified investment managers, but only those few that can advise to the level of size that, where they can afford to think about it.

Senator NICKLES. Basically, given the fact that a lot of those people would not qualify under the class exemption, you are still saying that instead of going through existing law, where basically it would be a prohibited transaction in the first place, you feel like the adequate consideration on arm's length basis would be the right method?

Mr. HARRIS. It worked very well through ERISA, the incentives caused plans to be maximized by this person wearing those several hats, and I think it would continue to work that way.

Senator NICKLES. Do you feel like this would be tight enough to stop that abuse which was alluded to? Secretary Donovan felt like it would not.

Mr. HARRIS. I appreciate your asking that question, because I especially noted his remarks that a plan sponsor who determines where the assets are to be spent, provides a considerably greater risk for abuse. That is true only where you do not have the plan sponsor or owner, who is a significant participant in the plan itself, and I think unless the small—large distinction is made, then the administrative problems of enforcement could come back to say well, we just have got to prohibit everything, because we do not have enough administrative time, money to stop these abuses, but the abuses do not take place in the 450,000 plans that exist, and I think that the statistics would bear that out.

So even if the adequate consideration test for some administrative need is not put back in place, it should be put in place for the small business community, because the problem does not present itself in that area to the same degree as it does in the large.

Senator NICKLES. I appreciate your comments. We are faced with somewhat of a dilemma, in the fact that we have a special meeting at 11:45. It is necessary for me to be there, and as well as the Majority members of the Senate.

I do have some additional follow up questions, and of course, we have several other people on later panels.

It is my intention to adjourn this hearing until 1:45 to try to let other people attend to their schedules and lunches.

Gentlemen, we do thank you, and our other panelists, as we get into this question of adequate consideration, et cetera. We would like to keep the record open so that we can submit additional questions to make sure that we accomplish what we are trying to do.

We will adjourn.

[Whereupon, at 11:43 a.m., the subcommittee recessed, to reconvene at 1:45 p.m., the same day.]

AFTERNOON SESSION

Senator NICKLES. We will begin.

On our next panel of witnesses we have Marvin A. Levins, senior vice president, American Council of Life Insurance; Theodore Groom, Esq., from the Prudential Insurance Co. of America, the Equitable Life Assurance Society of the United States, and others; and Charles A. Moran, senior vice president, Manufacturers Trust Co., American Bankers Association.

Gentlemen, welcome. I apologize to everyone for being 10 minutes late, and having to recess as early as we did.

It is our intention to go straight through to the balance of our panels. We have two additional panels. We would request that all persons please limit their oral testimony to 5 minutes, and all written testimony, of course, will be entered in the record in full. This will hopefully allow us to have additional time for questions.

We appreciate your input and expertise.

Mr. Levins, would you care to start?

STATEMENTS OF MARVIN A. LEVINS, SENIOR VICE PRESIDENT, GROUP PENSION AND REINSURANCE OPERATIONS, CONNECTICUT GENERAL LIFE INSURANCE CO., HARTFORD, CONN., ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURANCE; CHARLES A. MORAN, SENIOR VICE PRESIDENT, MANUFACTURERS TRUST CO., CHAIRMAN OF EMPLOYEE BENEFITS SERVICE COMMITTEE, AMERICAN BANKERS ASSOCIATION, NEW YORK CITY, N.Y., ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION; AND THEODORE R. GROOM, ESQ., GROOM & NORDBERG, WASHINGTON, D.C., ON BEHALF OF THE PRUDENTIAL LIFE INSURANCE CO. OF AMERICA, THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES, JOHN HANCOCK MUTUAL LIFE INSURANCE CO., CONNECTICUT GENERAL LIFE INSURANCE CO., AND AETNA LIFE & CASUALTY, A PANEL

Mr. LEVINS. Mr. Chairman, my name is Marvin Levins, I am senior vice president of the Connecticut General Life Insurance Co. in charge of its group pension operations. I am appearing today on behalf of the American Council of Life Insurance, which has a nationwide membership of 530 life insurance companies. These companies, in the aggregate, provide 97 percent of the life insurance in force in the United States and hold 99 percent of the assets of insured pension plans.

On behalf of the life insurance industry, I would like to commend you for your leadership role in spearheading the process for dealing with the debilitating restraints that now prevent my company and others from truly performing in the best interest of plan participants.

In my remarks I will outline some of the problems that the prohibited transaction provisions of ERISA entail. Ted Groom of the Washington, D.C., law firm of Groom & Nordberg, will testify after me on behalf of five major life insurance companies in the United States, including Connecticut General. Mr. Groom will describe the difficulties we have experienced in trying to obtain relief through the administrative exemption process, and outline solutions for the problems that have arisen under the prohibited transaction restrictions. The ACLI fully endorses his testimony.

Mr. Chairman, of all the provisions in ERISA, the prohibited transaction restrictions have proven to be the most burdensome to insurance companies and other financial institutions that manage pension fund assets. We do not object to costs that are incurred as the result of reasonable regulations, but these rules impose costs and burdens that are pointless.

The best way to illustrate our difficulties with the prohibited transaction rules is to focus on one section of the law, section 406(a) of ERISA. This provision, like the other prohibited transaction rules, was intended by Congress to prevent abuses by pension fund insiders. It prohibits insurance companies and other plan asset managers from engaging in transactions with any person who falls within any of the party-in-interest categories in this law.

There can be literally thousands of entities in a single category. To illustrate, one Fortune 500 company recently compiled a list of the parties-in-interest for its pension plans which included more than 100,000 parties-in-interest—and this list is constantly changing.

In addition, pension plan assets are often invested in pooled investment funds maintained by insurance companies or banks for reasons of diversity and economies of scale. A pooled fund usually invests in a particular kind of investment, such as common stock or, more recently, real estate. Typically, many separate plans will invest in a single pooled fund.

Because a single pooled fund consists of so many plans, the collective number of parties-in-interest can be staggering. Under ERISA's rules, the fiduciary of a pooled fund must be sure that none of these parties-in-interest is involved, directly or indirectly, in any of the thousands of investment transactions engaged in by the pooled fund every year.

Let me give you just one example of the problems we encounter under ERISA's party-in-interest restrictions. We manage a substantial portion of the pension plan assets of a large multinational manufacturing company. We face a violation of these rules if any of this company's products are purchased with its plan's assets. Because this company and its affiliates are engaged in such a wide range of different activities, it is virtually impossible to know whether we have committed a violation in many circumstances.

If, for example, a developer of an office building financed with this company's pension plan funds purchases paint from a very small affiliate of this multinational company, we have violated the party-in-interest restrictions. ERISA's definition of a party-in-interest is too broad. We believe that Congress did not intend to impose these rules on parties who, although related to a plan, are not in a position to influence plan investments.

If ERISA required that a party-in-interest transaction meet certain standards in order to be permitted, such as those proposed in your bill, we could structure all plan asset transactions to satisfy those standards, and be sure we were complying with the law. Instead, ERISA totally prohibits every party-in-interest transaction unless it is covered by a statutory or administrative exemption.

Therefore, to take advantage of what may be an attractive and prudent investment opportunity, a fiduciary of a pooled fund must determine whether any parties-in-interest are involved, and if so, whether any exemption applies. Since rules in this area are incomplete and complex, it is often impossible to tell whether a transaction is prohibited or whether an exemption applies. If no exemption appears to apply—and this is often the case—the fiduciary must incur a substantial cost and lengthy wait to try to obtain one. Of course, even if an exemption is obtainable, these delays and uncertainties often place the entire investment transaction in jeopardy, or cause the loss of a good investment.

Mr. Chairman, the insurance industry supported the prohibited transaction rules when ERISA was enacted because we strongly believed that participants and beneficiaries should be protected by effective fiduciary responsibility rules. We still believe that. But many of the current prohibited transaction restrictions are neither effective nor in the interest of participants and beneficiaries. Instead, they cost the parties to pension plans millions of dollars every year in lost investment opportunities and increased administrative expenses. This result can damage the viability of long-term pension fund investments, which in turn decreases the amount of benefits available for future retirees.

We appreciate the opportunity to testify on this important legislation, and would like to express in the strongest possible terms our support for the provisions in S. 1541 that would solve these problems. We would be pleased to respond to any questions you may have following Mr. Groom's testimony. Thank you.

[The prepared statement of Mr. Levins follows:]

STATEMENT BY MR. MARVIN A. LEVINS ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURANCE ON S. 1541 BEFORE THE LABOR SUBCOMMITTEE OF THE SENATE LABOR AND HUMAN RESOURCES COMMITTEE

January 26, 1982

My name is Marvin Levins. I am Senior Vice President, Group Pension Operations, Connecticut General Life Insurance Company.

I am appearing here today on behalf of the American Council of Life Insurance. The Council has a membership of 527 life insurance companies which, in the aggregate, have approximately 95 percent of the life insurance in force in the United States and hold 97 percent of the assets of insured pension plans.

We are pleased that the Subcommittee is holding this hearing devoted solely to the proposed changes to the fiduciary responsibility provisions of ERISA contained in S. 1541. Of all the provisions in ERISA, the fiduciary responsibility provisions, particularly the prohibited transaction restrictions, have proven by far to be the most burdensome and costly to insurance companies and others who manage pension fund assets. We do not object to costs we have to incur as a result of reasonable regulation, but the current prohibited transaction rules impose costs that are pointless and increase administrative expenses, potentially decreasing the benefits available to plan participants.

S. 1541 would make several changes in ERISA's fiduciary responsibility provisions. We strongly support these changes, particularly those affecting the prohibited transaction provisions and the provision that would exclude assets held in an insurance company's general account from the definition of plan assets. In particular, we strongly support sections 3505, 3511, 3501 and 3512 of S. 1541.

(Sections 3505 and 3511)---Application of Prohibited Transaction Provisions to Life Insurance Companies. Section 3505 would amend section 406(a)(1)(A)-(D) of ERISA (party-in-interest rules) to remove the current prior restraint restrictions and replace such restrictions with an arm's length or adequate consideration rule that would be applicable to all party-in-interest transactions. Section 3511 would exempt pooled investment funds maintained by insurance companies, banks and similar financial institutions from the rules of sections 406 and 407 of ERISA. We strongly support both of these changes.

The intent of ERISA's prohibited transaction rules is to prevent the abuse of employee benefit plan assets by persons who have discretion over the use of such funds. The present prior restraint prohibited transaction rules impose unreasonable, as well as unrealistic, restrictions on plan fiduciaries' transactions with parties-in-interest. Such fiduciaries are dealing, in most transactions, with a wide range of parties-in-interest, many of whom have no direct or indirect investment authority in connection with the plan assets involved in such transactions. Because of the size of these transactions, a fiduciary may not know the identity of all these parties-in-interest; and requiring him to learn the identity of parties that have no discretion with regard to a particular plan's investment activities is a fruitless exercise that is time-consuming and costly because such requirement serves no real purpose.

Sections 3505 and 3511 do not amend section 404 of ERISA. Therefore, the present strict fiduciary standards of conduct in section 404, including the requirement that a fiduciary act for the exclusive benefit of plan participants and beneficiaries, will not be affected. ERISA will still contain very adequate safeguards to protect the integrity of employee benefit plans from fiduciary abuses.

One of the most troublesome aspects of the prior restraint prohibited transaction restrictions is their application to investment transactions engaged in by life insurance companies. These restrictions require large institutional investors, such as insurance companies, to establish procedures and spend large amounts of money to be certain they do not violate the prohibited transaction rules. These procedures require an inordinate amount of checking of parties to various transactions and restructuring of investment transactions, in many cases, simply to avoid the application of these irrelevant rules. Because of the size of investment transactions commonly entered into by insurance companies, the number of parties-in-interest involved in such transactions is substantial. An institutional investor in these circumstances may be dissuaded from engaging in an otherwise attractive investment opportunity because of the risk of violating ERISA's prohibited transaction rules. Even more significant is that these rules are causing business people to consider whether to use retirement plan funds because of the various restrictions, checks, and representations that they have to endure to transact investment business with such institutions. ERISA's party-in-interest rules, therefore, inhibit the investment of pension plan funds in high quality properties managed by life insurance companies with no additional protection afforded plan participants.

Although ERISA provides an administrative exemption procedure that a fiduciary may use to gain protection for otherwise prohibited transactions, the time and expense required often renders such procedure useless to insurance companies. In addition, the limitations imposed by the Department of Labor in the past as a condition to the granting of administrative exemptions have proven to be quite restrictive. Further, the Department has generally been inordinately slow in processing class exemptions. For example, the current class exemption applicable to pooled separate accounts, Prohibited Transaction Exemption 78-19, was filed by the Council in early 1975. The final version of this exemption was not issued until December, 1978. During this four-year period, the industry and its employee benefit plan clients were not certain of the investment transactions that could be consummated even though such transactions were considered to be legitimate, attractive business transactions. Moreover, PTE 78-19 left so many unresolved issues, that the industry had to file a supplemental application for further exemptive relief.

We believe that the present statutory framework, which prohibits large numbers of investment transactions without qualification and requires a time-consuming, costly administrative exemption process to gain relief, is a clear example of over-regulation. The life insurance industry, which manages more than $100 billion dollars of retirement plan assets, is already closely regulated by both state and federal agencies. There is no substantive reason for subjecting institutional investors, such as insurance companies, to such over-regulation and lengthy exemptive procedures, which inevitably interfere with long-standing business transactions. Such interference results in lost investment opportunities and, in the long-run, will increase employee benefit plans' costs of doing business with insurance companies, without providing any significant advantage to such plans' participants and beneficiaries in terms of protection. We strongly support sections 3505 and 3511 of S. 1541 and urge their prompt enactment.

(Section 3512)--Ten Percent Limit on Acquisition and Holding of Employer Securities and Employer Real Property. Section 407 (a)(2) of ERISA provides that a plan may not acquire any qualifying employer security or real property, if immediately after such acquisition, the aggregate fair market value of such property held by the plan exceeds 10 percent of the value of the plan's assets. Our members have found this requirement to be extremely burdensome because of the difficulty of accurately determining whether this provision will be satisfied when a pooled separate account invests in securities or real property involving employers who maintain interests in the account making the investments. It is, many times, impossible to accurately determine the value of employer securities and real property held by a plan outside a pooled investment account each time the account engages in a transaction involving a particular investor employer's securities or real property.

We support section 3512 of S. 1541, which would amend section 407(a) to provide that assets held in a common or collective trust or pooled investment fund maintained by a bank or insurance company can be invested in qualifying employer securities or real property, up to 10 percent of the assets in such institution's funds, without regard to whether any such securities or real property are held in other investment accounts maintained by the plan.

(Section 3501)--Status of General Asset Account. Section 3501 of S. 1541 deals with the status under ERISA of contracts funded by a life insurance company's general account. We urge adoption of this provision, which clarifies existing law and Department of Labor and Internal Revenue Service interpretations. It would make clear that, in the case of a plan which is funded by a contract, or policy of insurance, based on the company's general account, it is the contract, or policy of insurance, that constitutes the plan asset, and not the underlying assets of the insurance company. A result, contrary to the amendment, would place impossible restrictions on an insurance company's investment activities in its general account by reason of the broad range of possible technical violations that could occur through dealing with "parties-in-interest". No participant safeguards would be lost by adopting this proposal.

Other Recommendations

In addition to the major issues discussed above, the Council recommends the following changes:

(1) Exemption for provision of ancillary services by a financial institution (section 408(b)(6) of ERISA). We urge that this provision be amended to clarify that it is applicable to life insurance companies. The Labor Department's present interpretation is to the contrary, although we can see no reason why the exemption in section 408(b)(6) should not be available to life insurance companies.

(2) Co-fiduciary liability (section 405 of ERISA). We strongly favor narrowing the situations where co-fiduciary responsibility exists in the case of a corporate fiduciary. Section 3504 of S. 1541 moves in this direction by clarifying that a named fiduciary to whom a specific duty has not been allocated shall not be responsible for an act or omission in connection with that duty by the named fiduciary to whom that duty had been allocated. However, section 3504 as drafted creates several ambiguities. We would appreciate the opportunity to further discuss this section with your staff at an appropriate time.

(3) Definition of party-in-interest. We would also appreciate the opportunity of discussing with your staff several changes in the party-in-interest definition which we have developed.

Conclusion

We believe that this package of amendments to the fiduciary provisions would provide a strong basis for life insurance companies to more efficiently comply with ERISA without any significant loss of ERISA's important protections. We commend you for focusing attention on this troublesome aspect of ERISA.

The Council appreciates having this opportunity to present our views. We would be happy to furnish any additional information which the Subcommittee may find useful.

Senator NICKLES. Thank you, Mr. Levins.

Mr. Groom?

Mr. GROOM. Mr. Chairman, I am Ted Groom, and I represent the five major life insurance companies which have already been identified.

I am going to "informalize," and sort of skip over my prepared oral remarks, by discussing this problem in the context of a couple of charts. Then I would like to comment briefly on some of the comments the Secretary made this morning.

On my right is a list of parties in interest. You can see we ran into a problem, Mr. Chairman, because even though we made a very great big chart, it is still very difficult for you to see it.

But basically, there are four major categories of parties in interest. There are fiduciaries with respect to the plan, employee organizations with respect to the plan, service providers with respect to the plan, and employers with respect to the plan.

If we stopped there, we would still have a major problem, but it would be somewhat limited. It is basically all of the additional relationships that end up creating the problem.

To give you a few examples, let us take an insurance company. Insurance companies or banks invest in a lot of oil and gas transactions in a partnership. Commonly they will be a 50-percent partner, and there will be other partners. Maybe a big insurance company or bank will invest the assets it manages in 2,000 real estate, or oil and gas deals, or many more. Every person who is a 10 percent or more partner in one of those oil and gas deals, or one of those real estate deals, is a party in interest with respect to any plan which the oil company is. So if some of your people in Oklahoma happen to be in oil and gas deals, they may be parties in interest, because of one of my clients.

A service provider can be an attorney, an accountant, an actuary. It can also be someone who takes care of a building. Service provider parties in interest also include employees of a service provider. Therefore, if you have someone out washing windows on the building, he is a party in interest.

"Employee organizations" has a somewhat awkward definition. It is not really the major problem, in terms of parties in interest, but unions are parties in interest, and various people related to them.

"Employers" is another problem, and that is where you get a large number of parties in interest, because if you have a major corporation it may have 1 major company that has 400 subsidiaries and affiliates. Every one of those affiliates is a party in interest. Each employee of the employer is a party in interest, and that may include 100,000 employees.

Now, if you have a commingled account, or a multiemployer plan in which you have many employers joining in, that just compounds the number of parties in interest. So our problem is that all of our normal investment transactions, with all of this large category of people, are prohibited under ERISA, unless we get an exemption.

We have tried to apply for a number of class exemptions. My second chart lists the nine major class exemptions that the insurance companies have applied for. Five of them have been granted, and four of them are still pending. We have also listed on the charts the approximate time that each exemption has been pending. You can see the shortest one, which still has not, we have not heard anything on it yet, has been pending a year. We have one major class exemption that involves over $8 billion of plan assets under management that has been pending for 5½ years, and we still do not have it.

So to try to solve this problem through granting class exemptions—we have made some progress on it, but it has been a very difficult problem.

If you have a specific investment transaction and you want to get an individual exemption from the Department of Labor, you can come in and they will act in 90 to 120 days, but you still have the problem in every investment decision, that time is of the essence. It costs money to prepare the application, there is a delay involved, and there are numerous examples, of lost investment opportunities because of these problems.

In our testimony we do make reference to the costs that are involved, and we estimate somewhat higher costs than was indicated this morning. We estimate that the cost probably averages out to somewhere around $25,000 for processing an exemption application. And if you multiply that by the number of applications that were filed with the Government in a recent year, you have a total cost somewhere on the order of $15 million.

So we very strongly support the provisions in your legislation that deal with these prohibited transaction problems.

If I may, I would like to comment briefly on the Secretary's testimony of this morning.

Senator **Nickles**. Would you like to reserve that for questions?

Mr. **Groom**. I would, fine.

[The prepared statement of Mr. Groom follows:]

Testimony of Theodore R. Groom

Mr. Chairman, my name is Ted Groom. I am a member of the Washington, D.C., law firm of Groom & Nordberg. I am testifying today on behalf of five major life insurance companies with a common interest in ERISA -- Prudential, Equitable, John Hancock, Connecticut General and Aetna.

As Marv noted, section 406(a) of ERISA prohibits absolutely any plan asset transaction involving a party in interest unless that transaction is covered by an exemption. The chart at the front of the room illustrates the extraordinary breadth of ERISA's definition of "party in interest." Not only are there numerous party-in-interest categories but, as Marv pointed out, many categories can include thousands of separate entities. Often these so-called parties in interest are so remotely related to the plan or pooled investment fund that they are not even aware of the connection themselves.

When ERISA was enacted in 1974, Congress recognized the breadth of the prohibited transaction restrictions and expressly stated its intent that the established business practices of financial institutions not be disrupted by these restrictions. To accomplish this, Congress included in ERISA an administrative exemption procedure under which the Department of Labor may grant exemptions for broad classes of investment transactions and arrangements.

Mr. Chairman, we believed for sometime after the enactment of ERISA that the Government would act promptly to provide relief for broad categories of investment transactions and would eventually solve the many problems that immediately came to light under the prohibited transaction rules. On a personal note, I can tell you that I was one of those who counseled patience while class exemptions were developed. However, after more than seven years of first-hand experience with the exemption process, we are convinced that administrative exemptions cannot and will not provide the necessary relief.

Consider the following facts. Of the nine major class exemptions that have been requested by the insurance industry for essential investment practices and services, only five have been granted. Much to our dismay, applications for class exemptions have been denied where no abuses have been shown to exist. In addition, as the table indicates, class exemptions have commonly taken three years, and sometimes five or six years, to process. Finally, even when issued, class exemptions have often included complicated conditions and exclusions that have undermined the purpose of the exemptions and frustrated the Congressional intent of providing relief for customary practices of professional asset managers.

Let me give you just on example of these problems and delays. We originally requested the class exemption for

INSURANCE COMPANY POOLED SEPARATE ACCOUNTS IN FEBRUARY 1975, SHORTLY AFTER THE ENACTMENT OF ERISA. AFTER ALMOST THREE YEARS OF DELAYS AND UNCERTAINTY, THE GOVERNMENT FINALLY PUBLISHED A PROPOSED CLASS EXEMPTION IN OCTOBER 1977. MORE THAN A YEAR THEREAFTER, IN DECEMBER 1978, THE CLASS EXEMPTION WAS FINALLY GRANTED. BUT EVEN AS GRANTED, THE EXEMPTION LEFT SO MANY IMPORTANT PROBLEMS UNRESOLVED THAT WE HAD TO FILE A SUPPLEMENTAL APPLICATION THAT IS MORE THAN 70 PAGES LONG. THIS SUPPLEMENTAL APPLICATION IS STILL PENDING, MORE THAN A YEAR AFTER IT WAS FILED.

ALTHOUGH THE GOVERNMENT IS ALSO AUTHORIZED TO GRANT EXEMPTIONS ON A TRANSACTION-BY-TRANSACTION BASIS, THE EXEMPTION PROCEDURE FOR INDIVIDUAL TRANSACTIONS HAS NOT PROVIDED ADEQUATE RELIEF FOR ASSET MANAGERS, EITHER. WHILE THE INDIVIDUAL EXEMPTION PROCESS NOW OPERATES MORE EFFICIENTLY THAN IT DID, THERE IS STILL A DELAY OF AT LEAST THREE OR FOUR MONTHS THAT IS INHERENT IN THE PROCESS. IT IS SIMPLY NOT POSSIBLE TO MANAGE EFFICIENTLY THE ASSETS OF AMERICA'S PENSION FUNDS IN THE FACE OF THESE LENGTHY DELAYS.

IN ADDITION, THE COST TO AN APPLICANT OF PREPARING AN EXEMPTION APPLICATION AND PROCESSING IT TO COMPLETION OFTEN TOTALS $25,000 OR MORE. THUS, WE ESTIMATE THAT THE COST TO THE PRIVATE SECTOR OF PREPARING AND PROCESSING THE 620

EXEMPTION APPLICATIONS FILED WITH THE GOVERNMENT IN 1980 WAS AT LEAST $15 MILLION. AND THIS FIGURE DOES NOT INCLUDE THE MILLIONS OF DOLLARS SPENT REVIEWING OTHER TRANSACTIONS FOR WHICH NO EXEMPTION APPLICATIONS WERE ULTIMATELY FILED, NOR THE HUGE COST OF LOST INVESTMENT OPPORTUNITIES.

IN SUM, THE EXEMPTION PROCESS HAS BEEN FRAUGHT WITH LONG DELAYS, ENORMOUS COSTS, AND REPEATED DISAPPOINTMENTS.

WE BELIEVE THERE ARE ANSWERS TO THESE PROBLEMS. WE STRONGLY SUPPORT THE REFORMS PROPOSED IN S.1541, AND APPLAUD THIS SUBCOMMITTEE FOR ITS WORK IN THIS AREA. IN PARTICULAR, WE SUPPORT THE AMENDMENT IN S.1541 THAT WOULD ELIMINATE THE REQUIREMENT THAT ALL PARTY-IN-INTEREST TRANSACTIONS BE COVERED BY AN EXEMPTION, AND WOULD INSTEAD REQUIRE THAT ALL PARTY-IN-INTEREST TRANSACTIONS SATISFY AN "ARM'S-LENGTH" OR "ADEQUATE CONSIDERATION" STANDARD. TOGETHER WITH THE OTHER FIDUCIARY PROTECTIONS AND ENFORCEMENT RIGHTS PROVIDED UNDER ERISA, AN "ARM'S-LENGTH" STANDARD FOR PARTY-IN-INTEREST TRANSACTIONS WOULD ASSURE THAT THE RIGHTS OF PARTICIPANTS AND BENEFICIARIES WOULD CONTINUE TO BE SAFEGUARDED. IT WOULD ALSO BRING AN END TO THE EGREGIOUS WASTE CAUSED BY THE CURRENT RULES, WHILE FREEING GOVERNMENT RESOURCES TO BE CONCENTRATED ON CASES OF ACTUAL ABUSE.

IN ADDITION, WE SUPPORT THE AMENDMENT IN S.1541 THAT WOULD RELIEVE "POOLED" INVESTMENT FUNDS FROM THE BURDEN OF

COMPLYING WITH THE PROHIBITED TRANSACTION RESTRICTIONS. NOT ONLY ARE THE PROBLEMS CAUSED BY THE RESTRICTIONS MUCH MORE ACUTE FOR POOLED FUNDS, BUT THESE FUNDS ARE SO DIVERSE AND COMPETITIVE THAT THEY PRESENT LITTLE OPPORTUNITY FOR ABUSE BY PARTIES IN INTEREST. AS THE TWENTY-YEAR HISTORY OF POOLED FUNDS DEMONSTRATES, IMPROPER PARTY-IN-INTEREST TRANSACTIONS HAVE SIMPLY NOT BEEN A PROBLEM FOR THESE FUNDS. THE DECISION BY A TRUSTEE TO INVEST IN A POOLED FUND IS ITSELF A FIDUCIARY DECISION, SO A MAJOR CONCERN OF THE MANAGER OF A POOLED FUND IS TO MAINTAIN ITS GOOD REPUTATION. IN ADDITION, NO ONE PLAN OR PARTY IN INTEREST HAS ENOUGH POWER THAT IT COULD INFLUENCE INVESTMENT OF THE FUND'S ASSETS. FINALLY, EACH OF THE MANY PLANS IN A POOLED FUND IS IN A POSITION TO MONITOR THE OPERATIONS OF THE FUND AND ASSURE THAT THE ASSETS OF THE FUND ARE PROPERLY INVESTED.

MR. CHAIRMAN, WE ALSO SUPPORT THE AMENDMENT IN SECTION 3512 OF S.1541 THAT WOULD IMPROVE THE OPERATION OF SECTION 407 OF ERISA, WHICH LIMITS PLAN INVESTMENTS IN THE SECURITIES AND REAL PROPERTY OF RELATED EMPLOYERS. WE SHALL DOCUMENT THE NEED FOR THIS CHANGE IN OUR WRITTEN TESTIMONY.

WE APPRECIATE THIS OPPORTUNITY TO TESTIFY IN SUPPORT OF THIS IMPORTANT BILL, AND WOULD BE HAPPY TO RESPOND TO ANY QUESTIONS YOU MAY HAVE.

LIFE INSURANCE COMPANY
EXPERIENCE WITH THE CLASS
EXEMPTION PROCESS

	Names of Class Exemptions In Order Applied For	Approximate Time Pending
1.	Pooled Separate Accounts	3 1/2 Years
2.	Sales of Contracts To/From Plans	1 3/4 Years
3.	Insurance Agents and Brokers	3 Years
4.	Discretionary Asset Management	5 1/2 Years*/**
5.	Affiliated Insurance Companies	3 Years
6.	Guaranteed Separate Accounts	4 1/2 Years
7.	Unrelated Service Providers	3 1/4 Years*
8.	Securities Exemption	2 3/4 Years*
9.	Unresolved Pooled Separate Account Problems	1 Year*

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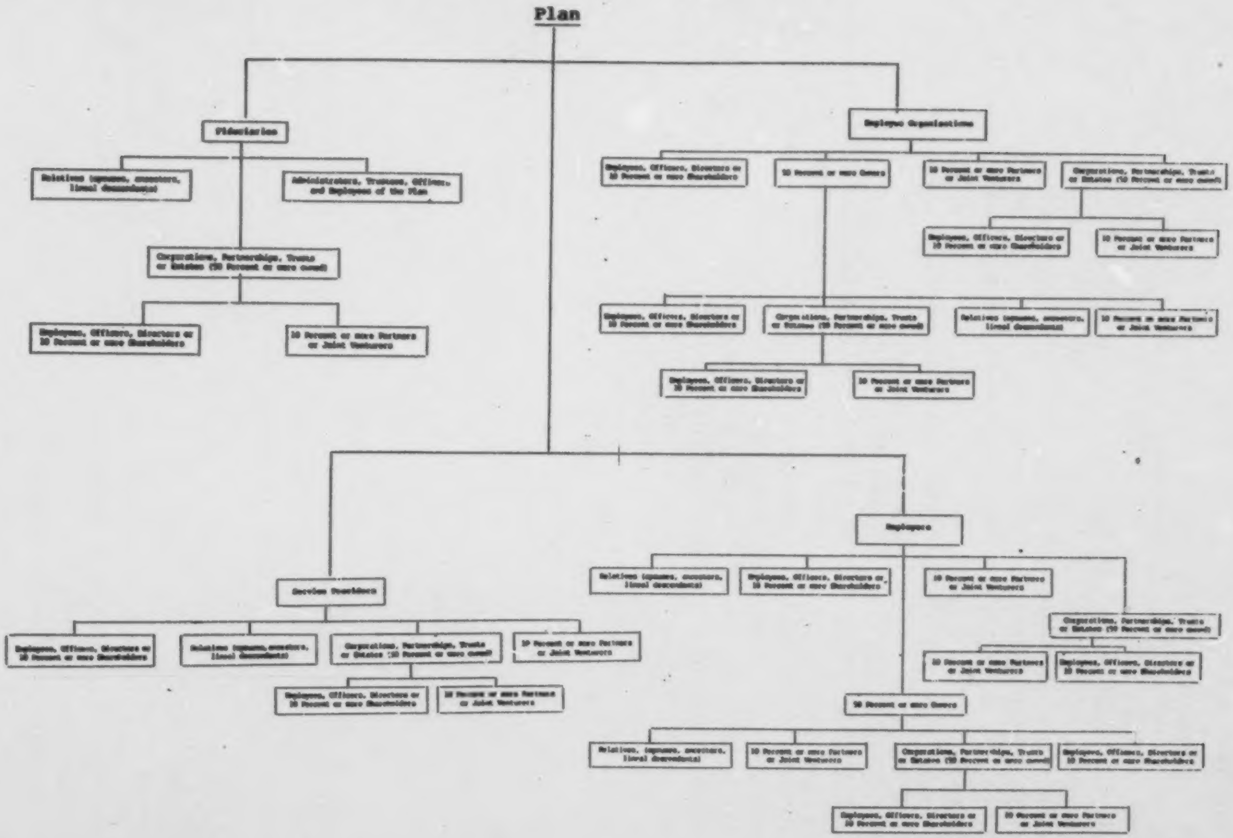
* = Still pending.

** = Combined time for interpretation/exemption request.

Parties-In-Interest Chart


Plan
Fiduciaries
Relatives (spouses, ancestors, lineal descendants)
Administrators, Trustees, Officers, and Employees of the Plan
Corporations, Partnerships, Trusts or Estates (50 Percent or more owned)
Employees, Officers, Directors or 10 Percent or more Shareholders
10 Percent or more Partners or Joint Venturers
Employee Organizations
Employees, Officers, Directors or 10 Percent or more Shareholders
50 Percent or more Owners
10 Percent or more Partners or Joint Venturers
Corporations, Partnerships, Trusts or Estates (50 Percent or more owned)
Employees, Officers, Directors or 10 Percent or more Shareholders
10 Percent or more Partners or Joint Venturers
Employees, Officers, Directors or 10 Percent or more Shareholders
Corporations, Partnerships, Trusts or Estates (50 Percent or more owned)
Relatives (spouses, ancestors, lineal descendants)
10 Percent or more Partners or Joint Venturers
Employees, Officers, Directors or 10 Percent or more Shareholders
10 Percent or more Partners or Joint Venturers
Service Providers
Employees, Officers, Directors or 10 Percent or more Shareholders
Relatives (spouses, ancestors, lineal descendants)
Corporations, Partnerships, Trusts or Estates (50 Percent or more owned)
10 Percent or more Partners or Joint Venturers
Employees, Officers, Directors or 10 Percent or more Shareholders
10 Percent or more Partners or Joint Venturers
Employers
Relatives (spouses, ancestors, lineal descendants)
Employees, Officers, Directors or 10 Percent or more Shareholders
10 Percent or more Partners or Joint Venturers
Corporations, Partnerships, Trusts or Estates (50 Percent or more owned)
10 Percent or more Partners or Joint Venturers
Employees, Officers, Directors or 10 Percent or more Shareholders
50 Percent or more Owners
Relatives (spouses, ancestors, lineal descendants)
10 Percent or more Partners or Joint Venturers
Corporations, Partnerships, Trusts or Estates (50 Percent or more owned)
Employees, Officers, Directors or 10 Percent or more Shareholders
Employees, Officers, Directors or 10 Percent or more Shareholders
10 Percent or more Partners or Joint Venturers

Senator NICKLES. If that is OK.

Mr. Moran?

Mr. MORAN. Thank you.

I have been identified as senior vice president of Manufacturers Trust Co. I think it is also relevant that I am chairman of the board of MH/Edie Investment Counsel, Inc., an investment management subsidiary of the bank, and chairman of the Employee Benefit Services Committee of the Trust Division of the American Bankers Associations. I come with both of those backgrounds, although I am representing the American Bankers Association this afternoon.

We are pleased to support your introduction of S. 1541. We find it particularly appropriate that you have singled out the fiduciary provisions of ERISA as the subject of this hearing.

ABA fully supports the intent of ERISA's fiduciary provisions, but has concluded that the prohibited transactions provisions are overly burdensome to investment managers and trustees, without providing any commensurate benefit to plan participants.

ABA strongly recommends the complete repeal of section 406(a). These provisions are unnecessary because of the fiduciary standards contained in section 404, already contained ample protection for plan participants. The number and variety of possible transactions that are prohibited by section 406(a) are enormous, and the vast majority could innocently be entered into in the plan participants best interests. It is burdensome for even the most diligent trustee to try to keep track of the ever changing list of parties in interest and to review all these relationships with respect to each and every plan transaction. This is particularly true where large U.S. companies and large plans are involved, and even worse for the Taft-Hartley Trust with multiple employers.

As burdensome as these provisions are to fiduciaries, it is more important to recognize that the prior restraints imposed by these prohibited transactions results in lost investment opportunities.

We wish we could quantify the total impact of lost opportunities, but that has simply not been possible. We cannot estimate the number valid class and individual exemptions that were never even applied for because of the time required, and the administrative and legal expenses involved.

In our written statements we have included examples of problems, such as the loss of additional income by plans from lending of securities during the 2 years that the class exemption for securities lending was pending.

I might point out, that even with that exemption there are still some points that have not been clarified, which has kept some people away from participating.

We continue to support your efforts and approach to solving the problems with prohibited transaction provisions. The substitution of standards relating to adequate consideration represents a major step forward, and we commend you for it. We differ only in suggesting that the repeal of section 406(a) is the most certain way to assure that future administrations will administer the law as you intend it to be administered.

I must take note here of the testimony earlier by Secretary Donovan. I applaud the philosophy for administering the prohibited transaction provisions that he has articulated. Unfortunately, past administrations have not taken such an enlightened view.

Therefore, I urge you to pursue your efforts, and to the extent that the Secretary's approach has appeal to you, that it be written into law. That would make a positive contribution to the certainty and stability of the future administration of ERISA.

We also believe that section 3505 of your bill might have the unintended effect of creating a duplicate set of fiduciary standards that could create an uncertain legal environment for plan fiduciaries. The fundamental standards of adequate consideration, undivided loyalty, exclusive purpose and prudence as required by ERISA Section 404 and are applicable to all plan transactions, not just those with parties in interest.

The reintroduction of these standards in the specific context of party-in-interest transactions raises the implication that these duties may be somehow different.

In addition, plan fiduciaries would still be required to engage in the tremendously burdensome and difficut process of identifying parties in interest.

Thus, it is the ABA's firm conviction that 406(a) should be repealed, not only because of the burdens it imposes are excessive in relation to the protection it offers plan participants, but also because it gives no substantive protections that they do not already enjoy under section 404.

I have two short comments on fiduciary status and cofiduciary durits.

Our association continues to be concerned about the definition of "fiduciary" contained in section 3(21) of ERISA. The term is defined so broadly that "fiduciary" could even include individual employees of a corporate trustee. Our written statement suggests written clarifying language. ABA also strongly supports efforts to clarify the scope and application of the cofiduciary responsibility rules as suggested in our written statement.

With respect to bank collective investment funds, the ABA strongly supports the objectives of sections 3511 and 3512 of the bill to exclude bank collective funds from the purview of ERISA, sections 406 and 407.

To eliminate overregulation of bank sponsored collective investment funds, however, we urge adoption of an amendment granting bank collective trust funds equal treatment with mutual funds. Our prepared statement includes suggested language.

Finally, legislative authority for mutual funds is now under consideration in the Senate Banking Committee. We earnestly solicit your support so that banks who wish to, may offer a single and registered mutual fund, or funds to their IRA, Keough and corporate employee benefit plan customers, as well as to the general public.

In conclusion, Mr. Chairman, let me express the sincere appreciation of trust bankers across the country to you for addressing the overly burdensome and technical fiduciary provisions of ERISA. We are fully supportive of your efforts, and we offer you our full cooperation.

We will be pleased to make ourselves available to you and your staff to elaborate on our comments, or provide any information that we can.

Thank you.

[The prepared statement of Mr. Moran follows:]

STATEMENT
OF THE
AMERICAN BANKERS ASSOCIATION

Mr. Chairman, I am Charles A. Moran, Senior Vice President, Manufacturers Hanover Trust Company and also Chairman of the Board of MH/Edie Investment Counsel, Inc. an investment management subsidiary of the bank. Presently I serve as Chairman of the Employee Benefit Services Committee of the Trust Division of the American Bankers Association and I come before you in that capacity. ABA is a national trade association whose members consist of more than 13,000 banks, more than 90 percent of the full service banks in the United States. More than 4,000 of these institutions are authorized to serve as fiduciary and many of these presently serve employee benefit plans in one capacity or another.

We are pleased to come once more before you and the members of the subcommittee to share our views on needed changes in ERISA. We congratulate you, Mr. Chairman, on your recognition of the many problems of ERISA and for the introduction of S. 1541. As trustees, investment advisors and custodians of employee benefit plans, banks are governed by the fiduciary responsibility provisions of ERISA. We support the intent of those fiduciary provisions but have concluded that the prohibited transactions provisions are overly burdensome to trustees, without providing any commensurate benefit to plan participants. We commend you for scheduling a hearing exclusively to address this portion of the law.

Prohibited Transactions

ERISA Section 406 enumerates a broad list of transactions into which a fiduciary of a plan many not enter. Subsection(b) prohibits transactions which are essentially self-dealing in nature. Subsection(a) on the other hand lists the activities into which a fiduciary may not cause a plan to enter with a "party in interest". A "party in interest" is defined to include an almost limitless class: an employer, or 50% owner of an employer, whose employees are covered by the plan, any counsel or fiduciary of the plan, or a relative of any of these. The term also includes employee organizations whose members are covered by the plan and any employee, officer, director, 10% shareholder or partner or joint venturer of an employer, service provider or employee organization.

The types of transactions prohibited include sales or exchanges of property, lending of money, furnishing goods or services and the transfer to or use by a party-in-interest of any of the plan's assets.

When one considers that many large plans have several banks, investment advisors and insurance companies, all managing portions of the investments, not to mention all the other entities which may provide services to the plan, total avoidance of prohibited transactions becomes virtually impossible in the ordinary course of business. For example, one investment manager could properly wish to invest in certificates of deposit of a bank which is trustee of another portion of the plan. Such purchase, without exemption, would be a violation.

The number and variety of possible transactions that are prohibited are enormous and the vast majority would be innocently entered into in the plan participants' best interests. It is unreasonably burdensome for even the most diligent trustee to keep track of the ever changing list of parties in interest and to review all these relationships with respect to each and every plan transaction. This is particularly true where large U.S. companies and large plans are involved. It is exceedingly difficult if not impossible for a bank trustee to even have knowledge of all the various employers in a Taft-Hartley trust, particularly when there would be no other reason to know them except for prospective prohibited transactions. Implementation of the needed procedures is expensive and time consuming, and serves no productive purpose other than avoidance of a violation of these provisions.

We were told at the time the prohibited transaction provisions were formulated that the exemption procedure would be applied so as to alleviate any unproductive and unreasonable burdens resulting from these provisions. The ABA however, has found the exemption procedure in Section 408(a) to be ineffective. We can say this from direct experience for we have obtained four class exemptions. Our first application was filed in December 1976 and was granted more than four years later in January 1981. Our second application, filed in January 1977, only took a little over 3 1/2 years, while our third, filed in May 1977, took a little less time. Our fourth application, filed in March 1979, was processed in a little less than two years, but was incomplete in that the Labor Department has not yet cleared banks to be compensated for the securities lending service involved. Furthermore, the restrictive conditions and limitations placed by the Department of Labor on class exemptions when they finally are granted limit their value.

As burdensome as these provisions are to fiduciaries, Mr. Chairman, it is even more important to recognize that the prior restraint imposed by these prohibited transactions has resulted in numerous lost investment opportunities and cost a great deal of potential income to plans. We wish we could quantify the lost opportunities, but that is simply not possible. For example, who can say how many plans were deprived of the additional income from the lending of securities during the nearly 2 year pendency of that class exemption? During most of that time one plan's participants were earning income from the lending of its securities because it had received an individual exemption. Even today plans are missing out on additional income from securities lending because some trustees are uncertain they can be compensated for this additional highly specialized and costly service without violating Section 406(a).

It is not our purpose to unduly lengthen the hearing record, however we must share with you some representative problems the prohibited transactions have created for plans. One member bank reports on a recent tender offer made by a corporation for whose pension plan the bank served as trustee. There were other tender offers made for the same target company. A trustee is required to review all the alternatives and act in the best interest of the trust in deciding what action to take. In this case, however, because of Section 406(a), the bank was unable to tender the stock of the target corporation held in the company's plan to that company even though the trustee independently may have concluded that it would have been in the best interests of the participants to do so.

Another case involved a plan sponsor which was 30 percent owned by another corporation which is a major issuer of corporate debt. Because the ownership exceeded 10 percent the plan is precluded from purchasing debt securities of the 30 percent owner. Those debt issues of the owner constitute a very major segment of the available high quality debt instruments. This case is particularly unfortunate because, had the plan sponsor been 50 percent or more owned, the debt could have been purchased under the employer security rules.

Another prohibited transaction problem is the purchase by a bank trustee of high quality securities, merely because the issuer happens to be a bank or insurance company which is managing another portion of the trust. This problem arises quite often, as does the situation in which a bank is named successor trustee and, in assuming control of the assets, finds its own securities among the portfolio investments.

Private placements, mortgages and mortgage related investments have become a nightmare of complexity because of Section 406(a) and the number and variey of service providers who may be involved. One of our member banks serving as custodian for the trustee of a plan was directed to purchase a long term mortgage on real estate. Upon investigation it turned out that the bank, on the commercial side and totally independent of the trust department, was the construction lender on the project. As a result the mortgage purchase was prohibited.

Any system of prior approval will result in many missed opportunities for plans because of the time delay inherent in the most efficient process. It is impossible to even attempt to estimate the number of exemption applications which were never filed because of the administrative burden and legal expense involved. The real cost is to the plan participants and their beneficiaries who lose the advantages of the added income and who must bear the considerable expense entailed.

Our Association, therefore, strongly supports the objective of Section 3505 of S. 1541 to do something about the prohibited transaction provisions. The substitution of standards relating to adequate consideration, adequate security, and reasonable rates of interest in lieu of the current "prior restraint" rule preserves the protections intended to be afforded by ERISA Section 406(a). It represents a major step forward and we commend you for it.

However, we should point out that Section 3505 might have the unintended effect of creating a duplicate set of fiduciary standards that could exacerbate confusion for plan fiduciaries. The fundamental standards of adequate consideration, undivided loyalty, exclusive purpose and prudence are required by ERISA Section 404 and are applicable to all plan transactions, not just those with parties in interest. The reintroduction of these standards in the specific context of party in interest transactions raises the implication that these duties may be somehow different in these situations. In addition, plan fiduciaries would still be required to engage in the tremendously burdensome and difficult process of identifying parties in interest.

Therefore, Mr. Chairman, while we applaud your effort, we must recommend the complete repeal of ERISA Section 406(a), and the definition of "party in interest" at ERISA Section 3(14). The fiduciary standards of ERISA Section 404 provide ample protection for plans without the unnecessary disruptions, confusion, or burdensome compliance requirements of the current prior restraint rules. The protections afforded by ERISA Section 404, in essence, make

Section 3505, as well as the current ERISA provisions relating to party in interest transactions, unnecessary. It would appear that the Department of Labor supports this view for in its enforcement efforts it has seldom relied exclusively on Section 406(a) in fiduciary actions. The Department customarily invokes the affirmative duties of Section 404 as well in seeking enforcement. In addition, legislation (H.R. 4928, introduced by Representative Erlenborn) is presently under consideration in the House of Representatives which does not include the prohibitions on party in interest transactions in the proposed law governing public employee plans.

Thus, it is ABA's firm conviction that Section 406(a) should be repealed not only because the burdens it imposes are excessive in relation to the protection it offers plan participants but also because it gives no substantive protections that they do not already enjoy under Section 404. Such a change would in no way affect the prohibitions against self-dealing transactions contained in Subsection 406(b).

Section 3102 of S. 1541 would conform the definition of party in interest to the disqualified person of the corresponding Internal Revenue Code provision, at least as it applies to an "employee". We feel this narrowing of the definition will be of some assistance but as discussed, it will not begin to solve our basic problem. The bill at the same time expands the field of "parties in interest" and "disqualified persons" by broadening the definition of "relative" in Sections 3103 and 4101. We are troubled by this expansion of an already overly broad category of persons and oppose it.

Mr. Chairman, we have attached an Appendix to our statement which offers some suggestions of a technical and conforming nature. We offer them for the Subcommittee's assistance as it prepares a final bill.

Bank Collective Investment Funds

Currently, banks administer their collective investment funds for employee benefit trusts under the Labor Department's Prohibited Transaction Exemption 80-51. The exemption has been justifiably criticized as being unduly restrictive and unnecessarily burdensome; moreover, it is based on the questionable assumption of the Labor Department that the assets of such collective funds constitute assets of the individual participating plans for purposes of ERISA's prohibited transaction rules. The burdens of compliance created by PTE 80-51 counteract some of the efficiencies and economies afforded by collective investment.

The ABA therefore strongly supports the objectives of Section 3511 and 3512 of the bill insofar as they relate to bank-sponsored collective investment funds. Section 3511 would exclude collective funds from the purview of ERISA Sections 406 and 407 by providing that assets of such funds are not to be considered plan assets for purposes of those provisions. Section 3512 would permit participating plans to disregard collective fund investments in qualifying employer property for purposes of computing compliance with ERISA Section 407 if the institution maintaining the fund provides the plan with a "written understanding or representation" that no investment of the fund in qualifying employer property shall exceed 10 percent of the separate trust.

The Association believes, however, that the rationale underlying the adoption of Section 3511 of the bill is identical to that which justified enactment of ERISA Section 401(b). That provision excludes mutual funds and certain assets of insurance companies from the purview of ERISA's fiduciary responsibility provisions. The exclusion was considered appropriate because the existing regulation of such funds made it unnecessary to apply the fiduciary rules of ERISA to protect plans investing in them. Bank collective funds are regulated by state and federal bank agencies and, furthermore, bank funds are trusts, thus banks are placed in a fiduciary relationship with respect to these funds. Since the provisions of S. 1541 are intended primarily to eliminate "overregulation" of bank-sponsored collective investment funds, we suggest that an amendment to ERISA Section 401(b) according such funds equal treatment with similarly situated mutual funds should be adopted in lieu of Sections 3511 and 3512 of the bill. We have included in the Appendix suggested language for this purpose.

As you may know, Mr. Chairman, banks have been making every effort to provide our recognized investment management capabilities to more and more people who desire our service, particularly individuals who may only have modest amounts for investment. Collective investment is the most efficient way to provide this service and, due to court rulings, banks must first seek legislative authority for mutual funds.

Such legislation is now under consideration in the Senate Banking Committee. We earnestly solicit your support so banks who wish to may offer a single registered mutual fund or funds to their IRA,Keogh and corporate employee benefit plan customers as well as to the general public. For purposes of ERISA, in terms of the substantive protection offered employees, the differences between bank collective funds and mutual funds are inconsequential and, therefore they should be treated similarly.

Fiduciary Status and Co-Fiduciary Duties

Our Association continues to be concerned about the definition of "fiduciary" contained in Section 3(21) of ERISA. The term is defined so broadly that "fiduciary" could even include individual employees of a corporate trustee. Every corporation must act through individuals but these individuals do not act in their own right or on their own behalf. To clarify this ambiguity we urge the Subcommittee to add the following language to the Section 3(21) definition of fiduciary: "(C) If a corporation or an employee organization is a fiduciary with respect to a plan, under subparagraph (A), a director or employee of such corporation or employee organization when acting in such capacity, shall not be a fiduciary with respect to such plan."

Mr. Chairman, ABA strongly supports efforts to clarify the scope and application of the co-fiduciary responsibility rules. We have long been concerned about the ambiguous language of Section 405(b) on the liability it creates for actions of co-fiduciaries. As proposed to be amended by Section 3504 of S. 1541 "each such trustee shall use reasonable care to prevent any other such trustee from committing a breach." Co-trustees have traditionally existed only where an instrument creating the trust grants more than one person authority to act in concert over the same trust assets. A separate and distinct situation exists where each of several trustees is given responsibility over a different portion of the trust's assets. A master trust arrangement, for example, may involve a master trustee with no investment duties and several other trustees each with investment duties for different portions of the plan (e.g., equity securities, fixed income securities, real property and international investment). To require each of these trustees to monitor each other's actions is inconsistent with the underlying policy of ERISA to permit allocation of duties and limitation of liability to duties assumed. We feel Section 405 should be amended to more accurately assign liabilities and that Section 405(b) should apply only where trustees are acting in concert over the same trust assets.

In conclusion Mr. Chairman let me express the sincere appreciation of trust bankers across the country to you for addressing the overly burdensome and technical fiduciary provisions of ERISA. We wish to assure you we are supportive of your efforts and we offer you our full cooperation. We will be pleased to make ourselves available to you and your staff to elaborate on our comments or provide any additional information.

APPENDIX

1. In the event Section 3505 is retained in substantially its present form, the Association recommends that the amendment be expanded to delete the phrase "or should know" from ERISA Section 406(a)(1). This provision implies that knowledge of a prohibited transaction may be imputed to a plan fiduciary under certain circumstances, and that fiduciaries have some duty of unknown dimensions to investigate or inquire into the background of all plan transactions, even though they have not assumed any responsibilities in this regard. The Association believes that the deletion of the offending phrase serves to confirm the basic intent of ERISA to impose responsibilities only on those persons who willingly and knowingly accept them. In addition, it preserves the basic idea that plan fiduciaries are entitled to allocate specific responsibilities among themselves, and to rely on the allocation in carrying out those responsibilities.

2. ERISA Section 408(b), which contains a number of statutory exemptions for certain party in interest transactions, should be examined and modified to conform with ERISA Section 406(a) as it may be amended. It appears that some of the exemptions afforded by ERISA Section 408(b) may no longer be necessary if amendments to 406(a) are adopted.

3. Suggested language to conform bank collective funds to

the treatment afforded mutual funds:

> "Section 401(b) of the Employee Retirement Income Security Act of 1974 is amended by adding the following new paragraph:
>
> 'In the case of a plan which invests in interests in (i) a common or collective trust fund or pooled investment fund maintained by a bank or trust company supervised by a State or Federal agency, or (ii) a pooled investment fund of an insurance company qualified to do business in a State, the assets of such plan shall be deemed to include such interests but shall not, solely by reason of such investment, be deemed to include any assets of such common or collective trust fund or pooled investment fund.'"

Senator NICKLES. Thank you, Mr. Moran.

I have a few general questions. The first of which will be to Mr. Groom, because I think you started to mention what the administration is now talking about regarding the class exemption. You provided us with charts showing the time, money, and difficulty in obtaining those class exemptions, in particular.

What did you think of the two class exemptions that were proposed today, and do you think that is going far enough?

Mr. GROOM. Well, we were particularly interested in the class exemption that involves professional asset managers, because that would be applicable to the—both the insurance companies and banks that are at this table.

I think our general reaction to the proposal is that it is a very constructive step, and we think that this Department of Labor is perhaps taking a somewhat different attitude and view toward these problems than the previous Department. So we think it is a good step.

We have a couple of concerns. One of them is simply that if it takes them 4 years to do this, then we must go another 4 years without knowing the answer, and our experience has been, with class exemptions, that it has been a very lengthy process. We think the committee could be helpful in overseeing this process as it goes along.

Second, one of the problems with class exemptions has been that each class exemption tends to have conditions in it, and the conditions spawn a whole new field of law, and people who have to administer those conditions.

I noted that in the Secretary's testimony this morning, he mentioned, for example, that one of the conditions that would be applicable in the exemption is that it would not be applicable to anyone likely to have the power to influence the investment manager.

Well, the whole concept of parties in interest was, that all of those people would supposedly have the power to influence the investment manager. So I do not know what they mean by that. If they mean something very narrow, then it would be acceptable. If they mean something very broad, we would be back where we started.

I would also agree with Mr. Moran's comments that in any event, we should codify the rules. The things they are suggesting would not cover a number of other problems that are covered by this legislation.

So, in any event, we would still support the enactment of the legislation that is in front of you.

Mr. **Moran**. I think you could only commend the Secretary for taking a strong step in the right direction. I think if the Department of Labor is able to act efficiently on this, you may be able to get something through the process by this fall, which would be surprisingly fast, and I think also would commend them.

You then have a problem, though, there is not going to be unanimity of agreement, that this is the best approach to take, and I do not know what that is going to do to the process. I could think of two significant groups that are going to be unenthusiastic of what he has proposed, although I would be very enthusiastic about it myself.

The other thing is the uncertainty that goes beyond, what happens when there is another administration in the Department of Labor, and how do they interpret things, and very importantly how are the courts going to interpret, and how quickly are you going to find out.

I encourage you to pursue your efforts, even if the Department of Labor's approach appeals to you. To codify that approach would be a big step forward with respect to both of those concerns of mine about the future.

Senator **Nickles**. As you know, Senate bill 1541 would replace the current prior restraints approach of parties-in-interest restrictions, with an adequate consideration standard.

In your opinion, if the proposed legislation were enacted today, would this open the door for abuses in the management of plan assets?

Mr. **Moran**. If I could make a quick comment first on that.

I do not have any notion that a bad guys are stopped by words, so I am not sure the words in the prohibited transaction section actually provide a great deal of protection. I think the fiduciary provisions, on the other hand, of ERISA, are adequate to provide the protection that is necessary.

Mr. **Levins**. Section 404 provides the protection as needed in that area, and that provision by staying in place, will continue to prevent any abuses, we believe.

Mr. **Groom**. Mr. Chairman, you know, I think this point is illustrated best by looking at the examples in the Secretary's own testimony.

The Secretary gave an example of what we are trying to prevent. And he says, let me give you a typical example, and a typical example of the problem they are concerned about is a fiduciary who wants to make a loan with the plan assets to his father. Now, that type of transaction is prohibited by the prudence rules, which say that you must manage the assets of the plan exclusively for the benefit of participants. And it is prohibited by the rules that say that the fiduciary cannot act in his own interest.

Neither of those rules would be changed by your bill. So, if you already have two laws that say you do not, you cannot do something, you do not really need a third one, in our view.

Senator Nickles. Let me compliment that with somewhat of a question.

I believe Mr. Levins and Mr. Moran stated that they would like to see 406(a), the parties-in-interest section eliminated, feeling that the prudent man rule would more than compensate, and arm's-length would be fair and equitable, and at all times protect the plan's interest.

Mr. Groom. I think there is not a significant difference between us on that issue. We basically came up here and said we support your bill. We agree that keeping 406(a) is somewhat redundant in that that is already required by the prudence rules, and so we would be quite content with the bill in the form in which you have introduced it, and we would be quite content with it in the form that Mr. Moran would like to see it.

Senator Nickles. I think the point that Mr. Moran was making is well taken. It could possibly be that somebody would say yes, in the parties-in-interest you are giving this, although that is already duplicating what is under 404.

I could see some reason for possible confusion, although it could be cleared up by the record, if we so desire to go that way.

However, we have exposed it, and brought it to light, and really the big question was whether or not we would go with that consideration or continue with the litany of parties-in-interest.

I wonder—and I guess this is a broad question—how many of either the big insurance companies or big banks, realizing the problem that, yes, it could enumerate into the thousands of trying to define parties-in-interest. If you own part of this hotel and the pension plan owns part of it, yes, you would have to check, and you could have a conflict of interest by staying in that hotel, or eating in that hotel. How much of a problem is that?

Granted there could be some conflict in your current law, but it is not really perceived in my mind that Labor would ever "go that far" in their efforts to enforce the law.

Mr. Levins. Mr. Chairman, it is a problem, and the fact that it would be enforced or not ~~is~~ academic. Because under the law, we are in technical violation. So we must go through each of those transactions and verify, to our acceptance, that there is nothing that is prohibited in that relationship.

To give you an example, at Connecticut General we have about 50 people who at various times deal with those problems, and in all instances it is primarily to make sure that there is nothing that exists that could be perceived to be prohibited, even though in all probability, in all cases they are proper.

Senator Nickles. Let me say that Connecticut General, or Equitable, or any other major company, is investing funds for a major conglomerate, a Tenneco, that has several different companies, and they are assigning you a percentage of their portfolio. Let us say one company is taking a 10th of it, and they invest the funds, and divide it up in that regard.

Do you have many of your investment managers working on portfolio management, and spending a great deal of other time researching to make sure that there are no potential parties-in-interest, where they would have to get exemption?

Mr. **Levins**. Absolutely. The portfolio manager feels a strong sense of ownership, and must assure himself, or herself, that there is nothing in that transaction that could be a violation of the law.

So a lot of their time is spent in this area. It is not so much the time, but the lost opportunities. There are many investments that we lost out on that affect the participants in the fund, because of the timeframe involved in checking these out.

I am sure you are aware, as a businessman, that timing is critical in many of these issues, and that probably causes us more problems in terms of being able to perform well.

Senator **Nickles**. I think that is a good point to be made. If your portfolio managers are doing their work, if they were going to invest money in this conglomerate, would they go beyond trying to check out the major companies that were in that conglomerate, to see that they were not? How far down would they actually go to really insure that there is no conflict, or prohibited transaction taking place? To insure that, you could have all actuaries, or the services people, or the employees, or employee groups, or any related that you could greatly expand.

I do not know that anyone could contest the fact that the prohibited transactions could technically go very broad. In reality, how much do the investment managers really try to go to insure that there is no regular transactions?

Mr. **Levins**. They will go to a great deal of investigation on it, but they will have to pass up the opportunity, because they are not sure. They cannot dig in it deeply enough, quickly enough, and therefore they will pass on the opportunity.

Senator **Nickles**. They will pass on the opportunity, time is money, and so they will invest it in something that they feel secure in?

Mr. **Levins**. Correct.

Mr. **Groom**. There is risk if you engage in a prohibited transaction, even though it is a totally innocent one. Let us say that you have some real estate in your plan and it turns out that you have executed a lease with Newport News, which happens to be a subsidiary of Tenneco, and that would be a prohibited transaction, if your plan has some Tenneco assets in it.

Now, two things can happen to you. One is if that building turns out, through economic conditions or through the fortunes of investment not to be a good investment, the fact that you have made that investment, if you have a loss on the investment, and you have engaged in a prohibited transaction, may create civil liability of many millions of dollars for that loss.

There is also an excise tax liability, which is 5 percent of the amount involved, and that accumulates. So that you can have a very substantial liability if you do engage in one of these prohibited transactions, even though it is a prudent investment at the time you made it. That is why, particularly the "good guys" go to great lengths to discover and try to be sure that they are not engaging in a prohibited transaction.

One of the ironies is that people who are investment managers have to go out and try to find out who is an insider. A lot of the effort that Mr. Levins has just described involves people trying to find out "is this person an insider?" which seems sort of ironic.

Mr. MORAN. That is a good point. If I might add to your question about how far those investigations go. There is no way to take them to the *n*th degree, and what happens is the portfolio manager will always look to those who are in a position to influence a decision.

So that where it stops is where there would be an innocent dealing with a party-in-interest. First of all, it is very unlikely that you would even discover those situations. With all of this uncertainty out there, why are we still in the business of investment management? I think this is a good question. Going back in late 1974 and 1975, there were a number of us that took a serious look as to whether we could continue in the business of providing investment management services under prohibited transactions constraints. Most of those decisions to continue that I am aware of, were based on the fact that with the kind of investigations that we could complete, we could assure that we did not intentionally engage in a transaction that caused harm to the plan. While that is not necessarily technical compliance, it certainly was compliance with the spirit and the intent of the law, and until you are hung on something like that, you can continue as a business decision to continue on that basis.

I would further add, that if you want to find a prohibited transaction in any account that exists, you could find it. All you have to do is look long enough. The prohibited transactions provisions are that pervasive.

Senator NICKLES. One additional broad question.

If we did adopt the adequate consideration, and that was current law, how would that really lessen your burden, or the delays in time and expense that you now have in complying with with ERISA?

Mr. LEVINS. It would identify the standards that you operate under. As long as it is an arm's-length transaction, which is definable, it would give us the standards under which to operate, and we would not be saddled with this problem which we have now, of parties-in-interest.

Mr. MORAN. A one-sentence response is that it would allow the investment managers to make investment decisions, solely on investment criterion, without investigative reviews.

Senator NICKLES. Do you feel like, that, in any way, would lessen or detract from the security of the pension investment across the country?

Mr. MORAN. Not at all.

Mr. GROOM. One good example, I think a better example than the Secretary gave, is: Connecticut General wants to buy a building from Manufacturers Hanover, and they both happen to be managers for the same pension plan—which is commonly the case in the case of a large plan—that transaction, even though it is between two people who are competitors, is a prohibited transaction, and it is ridiculous.

These guys are not going to give one break in the world to the other guy. That is one of the most common types of transactions that we are concerned about right now.

Senator NICKLES. Gentlemen, I thank you very much.

I would like to state, for your purposes and others, that Senator Kennedy, and possibly a couple of other Senators, would like to keep the record open. We will keep it open for 2 weeks, and would like to have you respond to our additional questions for the record during that period of time. Thank you very much.

Our next panel is Steven Zaleznick, legislative representative of the American Association of Retired Persons; Stephen Bruce, deputy director, Pension Rights Center; and Michael S. Gordon.

Gentlemen, welcome.

Steve?

STATEMENTS OF STEVEN ZALEZNICK, LEGISLATIVE REPRESENTATIVE, AMERICAN ASSOCIATION OF RETIRED PERSONS, WASHINGTON, D.C.; STEPHEN R. BRUCE, DEPUTY DIRECTOR, PENSION RIGHTS CENTER, WASHINGTON, D.C.; AND MICHAEL S. GORDON, LAW FIRM OF MITTLEMAN & GORDON, WASHINGTON, D.C., A PANEL

Mr. ZALEZNICK. Thank you, Mr. Chairman.

My name is Steven Zaleznick, and I am here on behalf of the National Retired Teachers Association and the American Association of Retired Persons. We appreciate the opportunity to appear at this hearing because we feel that the fiduciary provisions of S. 1541 are important aspects of this legislation. This section of S. 1541 appears to be a response to some of the difficulties of implementing the prohibited transaction rules that are contained in present law. The associations feel, however, that the remedy outlined in S. 1541 is not the proper solution to these problems, because it could jeopardize the pension benefits of retirees and workers.

Strong fiduciary obligations for the managers of pension trusts are crucial elements of a sound public policy governing the private pension system. The duty of a plan fiduciary must be to secure the highest rate of return for the pension fund. This concept is especially important to retirees because it offers the greatest possibility for assistance in an inflationary environment. If plan sponsors are to provide some compensation for the effects of inflation, the money must come from somewhere. A high investment yield on the trust funds is the most promising source.

While many pension benefits are guaranteed by the Pension Benefit Guaranty Corporation, retirees and workers have a definite interest in seeing that their pension plan's assets are invested in the most prudent manner. Also, we believe that the Federal Government should be sure that the tax expenditure designed to encourage pension plan formation is not instead seen by a plan fiduciary as a subsidy for the creation of a capital pool to be used by a party-in-interest.

Fiduciary principles are particularly important for private pension trusts because retirees—and very often active workers—generally have little control over major financial decisions. If a retiree is not satisfied with the performance of his/her pension fund, there is very little that can be done in response. Rarely can the retiree move the money elsewhere. Enforceable fiduciary provisions must fill in where these marketplace forces are missing.

The associations feel that section 3505 is the most important of the fiduciary provisions in S. 1541. Section 3505 would repeal current law, which prohibits party-in-interest transactions unless they are specifically allowed by statute or by a decision of the Department of Labor. In its place, the new provision would permit a party-in-interest transaction as long as adequate consideration is exchanged in the bargain.

We recognize that many, and maybe even most, party-in-interest transactions do not harm the pension plan. Also, because the definition of party-in-interest is broad, large plans are likely to find that many transactions are technically party-in-interest transactions, yet not at all abusive.

While we are sympathetic with the problems that led to section 3505, we believe that this section ignores the fact that party-in-interest transactions, if left alone, can be very abusive. We also feel that an adequate-consideration standard will effectively permit party-in-interest transactions with very few exceptions.

We do not see how a defective party-in-interest transaction could be remedied under section 3505, particularly by the Department of Labor. First, the Department would have to recognize that an exchange was in fact a party-in-interest transaction. Second, the Department would have to prove that adequate consideration was lacking. And even if a transaction initially provides for adequate consideration, it is unlikely that the Department could monitor the arrangement throughout the years to make sure adequate consideration remains.

This subcommittee has before it a General Accounting Office study which suggests that the Department of Labor does have the resources to adequately perform all of its functions in the ERISA reporting and disclosure area. The section 3505 adequate consideration standard will only add to this burden by creating a need to thoroughly police many more transactions. If this burden is not met, retirees and workers could suffer through a decline in the value of their pension trust.

We hope that the subcommittee, through these hearings, will review other remedies to the problems that plan fiduciaries have with the present structure of the party-in-interest law. Our preference would be for these remedies to be found through the administrative exemption process. If this route is not available, perhaps additional statutory exemptions, with sufficient safeguards for plan participants, could be designed. However, we cannot accept legislation which would reverse the general rule that party-in-interest transactions are to be prohibited.

That concludes my statement, Mr. Chairman. I would be happy to answer any questions.

Senator NICKLES. Mr. Bruce?

Mr. BRUCE. I appreciate the opportunity to testify before the subcommittee today on the fiduciary sections of S. 1541.

Pension funds are unique. They are unique because they are the largest new source of capital in the economy. They are unique because transactions involving fund assets are largely unmonitored by the Government or by outside parties. And they are unique because the individuals engaging in transactions on behalf of the funds are individuals with strong, conflicting, and in many cases, overriding corporate, union and institutional interests.

The prohibited transactions provisions in ERISA were designed to address the conflicts inherent in these pension trust arrangements. Congress recognized that the most pervasive of the conflicts are those that arise when plan trustees and investment managers have close personal and financial relationships with corporate and union sponsors, their officials and service providers. The evidence was overwhelming that it was unrealistic to expect that trustees, even the best intentioned, would remain unaffected by these relationships.

ERISA's sponsors knew the prohibited transactions sections were not perfect but those provisions were, politically and practically, preferable to any available alternative.

Congress could have dealt with the conflicts of interest problem by requiring that plan assets be managed exclusively by independent fund managers with no ties whatever to corporate and union sponsors. This would have meant the creation of pension investment institutions independent of existing financial institutions and would have meant giving participants, rather than employers, the exclusive right to choose where their funds were invested. The legislative proposal presenting this alternative was not considered politically feasible in 1974.

Congress also had the option presented by this bill. It could have allowed trustees to in effect be the sole judges of the reasonableness of their own actions, regardless of the conflicts presented by particular transactions. This, as a practical matter, would have been no deterrent to abuse.

The adequate consideration standard, which now appears in this bill, was proposed in 1974 and was already in section 503(b) of the Internal Revenue Code before ERISA—and remains there today. It was at that time, and still is, by almost all accounts, completely unenforceable. There are a number of problems, but the key is that the adequate consideration standard is unenforceable.

We are not saying that section 404 is not sufficient as a standard of duty. The point is that section 406 is necessary to make the standard of section 404 enforceable in instances where the plan is dealing with people who have close relationships to either the corporate sponsors, the union, or to the fiduciaries who administer the plan.

The most important problem in enforcing an adequate consideration standard in these instances is that the determination of adequacy will be made by people who have a much more concrete relationship with the parties on the other side of the transaction than they do with the people who are the plan's participants and beneficiaries.

Second, policing an adequate consideration standard is impossible. Often only two parties—both interested—are even aware of the existence of a particular transaction. If it is discovered by a participant or third party, almost invariably it is years after the transaction took place and the burden of proving that consideration was inadequate becomes virtually impossible. The Department of Labor's ability to monitor transactions is already very limited—

with less than 200 investigators nationwide—and its enforcement efforts are already widely regarded as poor.

Finally, the adequate-consideration standard removes the deterrent force of prior review. Fund trustees are insured, and often covered by indemnification agreements, despite the arguable illegality of the practice. They serve as trustees for limited periods of time and would have virtually nothing to lose, personally or professionally, by gambling that a particular transaction would never be called into question after the fact. Prior review, the criminal penalties for not reporting prohibited nontransactions, and the automatic excise tax, are the most important deterrents in the law.

There is even greater reason now than in 1974 to reject the adequate-consideration standard. The recession is pushing an ever-increasing number of companies into financial straits. It is simply unrealistic to expect a plan trustee with close personal or financial ties to a failing company to view with objectivity a transaction that will help the failing company in the short term, even at the expense of the long-term interests of participants.

For participants, adoption of an adequate consideration standard would be a disaster. There is too much at risk.

In defined contribution plans the risk is obvious. The value of participant accounts fluctuates directly with the funds' rate of return, and no insurance is provided by the PBGC. A leaseback arrangement between a plan and corporate sponsor might not be noticed until participants retire and discover their pensions are only a small fraction of what they could have been.

For defined benefit plans, the risk for participants while less direct, can be equally great. A low rate of return can mean a substantial reduction in the size of retirees' pensions. Technically "accrued benefits" generally can not be reduced, but prospectively benefits can be reduced and eligibility requirements changed to compensate for poor returns and losses. The general rule is that a 1 percent lower return can mean an effective reduction of 20 percent in the plan's ability to pay benefits.

Moreover, if a plan terminates or gets into serious financial trouble, "accrued benefits" can be eliminated or reduced substantially.

Pension assets, as the Wall Street Journal recently noted, cannot be "played around with lightly, without jeopardizing retirement security."

It may well be that the Department of Labor's exemption procedures are not perfect. It may be that there have been delays. It may even be that an occasional investment opportunity is missed. But there is no reason why these procedures cannot be made more responsive and no one has suggested an enforceable alternative, that will adequately protect the interests of participants and beneficiaries.

Thank you.

[The prepared statement of Mr. Bruce follows:]

STATEMENT OF
STEPHEN R. BRUCE
DEPUTY DIRECTOR, PENSION RIGHTS CENTER
ON S. 1541
BEFORE THE
SENATE SUBCOMMITTEE ON LABOR
JANUARY 26, 1982

Mr. Chairman, Members of the Subcommittee, my name is Stephen Bruce. I am Deputy Director of the Pension Rights Center. The Center is a nonprofit organization established to educate the public about pension issues, protect the pension rights of workers, retirees and their families, and offer solutions to retirement income problems.

I appreciate the opportunity to testify before the Subcommittee today on the fiduciary sections of S. 1541.

Pension funds are unique. They are unique because they are the largest new source of capital in the economy. They are unique because transactions involving fund assets are in fact largely unmonitored by the government or by outside parties. And they are unique because individuals engaging in these transactions on behalf of the funds are individuals with strong, conflicting, and in many cases, overriding corporate, union and institutional interests.

The prohibited transactions provisions in ERISA were designed to address the conflicts inherent in pension trust arrangements. Congress recognized that the most pervasive of these conflicts are those that arise when plan trustees and investment managers have close personal and financial relationships with corporate and union sponsors, their officials and service providers. The evidence was overwhelming that it was unrealistic to expect that trustees, even the best-intentioned, would remain unaffected by these relationships.

ERISA's sponsors knew the prohibited transactions sections were not perfect but those provisions were, both politically and practically, preferable to any available alternative.

Congress could have dealt with the conflicts of interest problem by requiring that plan assets be managed exclusively by independent fund managers with no ties whatever to corporate and union sponsors. This would have meant the creation of pension investment institutions independent of existing financial institutions and would have meant giving participants, rather than employers, the exclusive right to choose where their funds were invested. The legislative proposal presenting this alternative was not considered to be politically feasible in 1974.

Congress also had the option presented by this bill. It could have allowed trustees to in effect be the sole judges of the reasonableness of their own actions, regardless of the conflicts presented by particular transactions. This, as a practical matter, would have been no deterrent.

The adequate consideration standard, which now appears in this bill, was proposed in 1974 and was already in Section 503(b) of the Internal Revenue Code before ERISA (and remains there today). It was at that time, and still is, by almost all accounts completely unenforceable. There are a number of problems:

> First, and most important, the people who make the determination of "adequacy" have an interest in the transaction that for them is typically much more concrete than what is likely to seem an abstract, even remote, obligation to act "solely in the interest" of plan participants and beneficiaries. One need only read the justifications of the Grumman trustees, who were corporate officers, to see this process at work.
>
> Second, policing an adequate consideration standard would be impossible. Often only two parties -- both interested -- are even aware of the existence of a particular transaction. If it is discovered by a participant or a third party, almost invariably it is years after the transaction took place and the burden of proving that consideration was inadequate is virtually impossible. The Department of Labor's ability to monitor transactions is very limited (with less than 200 investigators nationwide) and its enforcement efforts are generally regarded as poor. See the Senate Permanent Subcommittee on Investigations hearings into the Central States case, and more generally, the recent GAO Report "Better Management of Private Pension Plan Data...." If a transaction involves either a very small company (less than 100 participants) or very large institution, there is a very real possibility the Department will simply refuse to become involved. As for the likelihood of participant-initiated lawsuits against the trustees, few, if any, participants have the resources necessary to pursue this kind of complex, factual and protracted litigation.
>
> Finally, the adequate consideration standard eliminates the deterrent of prior review. Fund trustees are insured, and often covered by indemnification agreements (despite arguable illegality of the practice). They serve as trustees for limited periods of time and would have virtually nothing to lose, personally or professionally, by gambling that a particular transaction will not be called into question after the fact.

There is even greater reason now than in 1974 to reject the adequate consideration standard. The recession is pushing an ever-increasing number of companies into financial straits. The temptation that pension money poses in these circumstances can be overwhelming. It is simply unrealistic to expect a plan trustee with close personal or financial ties to a failing company to view with objectivity a transaction that will help the failing company in the short-term, even at the expense of the long term interests of participants.

Moreover, there is increasing concern, as suggested in the "American Management" series appearing in the Washington Post last week, that investing pension fund money to meet the short-term corporate objectives of plan sponsors not only hurts the fund but may also be hurting the economy as well.

Now more than in 1974, there is the similar temptation for Taft-Hartley trustees, faced with declining union employment, to find pressing reasons for using pension fund monies to help fund employers who provide union jobs, even if, objectively viewed, other investments might better meet the retirement income security needs of participants.

For participants, adoption of an adequate consideration standard would be disastrous. There is too much at risk.

In defined contribution plans the risk is obvious. The value of participant accounts fluctuates directly with the funds' rate of return, and no insurance is provided by the PBGC. A leaseback arrangement between a plan and corporate sponsor might not be noticed until the participants retire and discover their pensions are only a small fraction of what they could have been.

For defined benefit plans, the risk for participants while less direct, can be equally great. A low rate of return can mean a substantial reduction in the size of retirees' pensions. Technically "accrued benefits" can generally not be reduced, but prospective benefits can be reduced and eligibility requirements changed to compensate for poor returns and losses. The general rule is that a 1% lower return can mean an effective reduction of 20 percent in the plan's ability to pay benefits.

Moreover, if a plan terminates or gets into serious financial trouble, accrued benefits can be eliminated or reduced substantially.

Pension assets, as the Wall Street Journal recently noted, thus cannot be "played around with lightly without jeopardizing retirement security."

It may well be that exemption procedures are not perfect. It may well be that there are delays. It may even be that an occasional investment opportunity is missed. But there is no reason why these procedures cannot be made more responsive and no one has suggested an enforceable alternative.

With your permission I would like to submit a more detailed statement on the other fiduciary sections of the bill.

Thank you again for the opportunity to appear here today.

Senator **Nickles**. Thank you.

Mr. Gordon?

Mr. **Gordon**. Thank you.

My name is Michael S. Gordon. I am a partner in the law firm of Mittelman & Gordon, a Washington, D.C., law firm, that among other things, specializes in ERISA and the employee benefits field. During the period 1970–75 I served under an appointment by Senator Jacob K. Javits as minority counsel for pensions for the U.S. Senate Committee on Labor and Public Welfare and participated in the drafting and legislative process that culminated in the enactment of ERISA.

Prior to that time, I had served as the U.S. Department of Labor's counsel to President Kennedy's Cabinet Committee on Corporate Pension Funds, which issued a report in 1965 that recommended widespread regulatory reforms in the private pension field. In addition, during 1972–73 I also served as minority counsel to the U.S. Senate Select Committee on Small Business and helped to formulate and participate in a series of investigations pertaining to the Federal paperwork burden on small business, which I believe was one of the original investigations into the subject.

I would like to commend you, Mr. Chairman, for holding these as well as other hearings on S. 1541, the Retirement Income Incentives and Administrative Simplification Act, and related legislation and express my appreciation for granting me this opportunity to appear and testify today and return to the scene of my crimes.

I was reading the other day about a gentleman who is a famous linebacker for the now champion San Francisco Forty-niners, who got the name Jack "Hacksaw" Reynolds apparently out of frustration, when his team lost a game with an important rival and he sawed a car in half in 1½ days with a hacksaw.

I wish to assure you, Mr. Chairman, I come not with a hacksaw, but with a scalpel, and the scalpel is directed at the prohibited transaction proposals in this bill, S. 1541.

This is a tough subject, one that has been argued in six administrations. It goes all the way back to President Kennedy's administration. Each time the question has come up as to whether "adequate consideration" would provide an appropriate means of controlling conflicts of interest abuses in private pension and welfare funds. Each time the kinds of arguments that we have heard today have been made.

There also has been a rather substantial record of abuses that were committed approximately between 1942 and 1974, when adequate consideration was the test in the Internal Revenue Code for trying to deal with conflicts of interest in pension plans.

The almost overwhelming conclusion of every administration that has gone into this, and the conclusion of the Senate-House conference in 1974 on ERISA, despite the fact that this terrain was fiercely fought over, as it is now, was that adequate consideration simply does not work as a means of checking party-in-interest abuses.

Now, frankly, I wish that it did. I am a practitioner in this field now, and I have had dealings with a wide variety of clients. I can tell you that the exemption procedure is a pain in the you know what.

But when we consider the alternatives, going back to adequate consideration, in my judgment, simply will not do the trick.

I have listed a number of examples in my written testimony starting at page 7, of the kinds of conflict-of-interest abuses that took place prior to the passage of ERISA, which convinced a number of congressional committees, including the administrations that testified before them, that adequate consideration was not workable, and these started with the revelations of Senator McClellan's Subcommittee on Permanent Investigations, which involved conflicts-of-interest abuses in certain union health, welfare, and pension plans. Also discussed are some of the problems that Mr. Jimmy Hoffa had in connection with his mail fraud conviction in 1964, which really was not about mail fraud at all, although that was the technical angle that was used to convict him. You could not convict him on the grounds of fiduciary violations because there was no adequate fiduciary law then, and yet some of the things that he did were clear party-in-interest or conflict-of-interest transactions, and they were not stopped by the Internal Revenue Code. The Internal Revenue Service did not do anything to the tax exemption of the Central States Teamsters Fund, prior to ERISA, as a result of the standards in the code.

I also describe other abuses that took place involving employer funds. By no means should this be interpreted as an exhaustive listing. There are many more, and I might add that nobody, absolutely nobody, was an angel in this field, not small business, not insurance companies, not banks. There were banks that were responsible for directing and maintaining investments in Penn Central stock, while at the same time they had a creditor position in Penn Central, they maintained those investment positions on behalf of pension funds that they served, when everybody else was getting out.

It would be wonderful if everybody was an angel. Unfortunately, it is not the case.

Now, I have described here, on page 12 of my testimony, a few of the kinds of party-in-interest transactions that would be sanctioned, as I see it, by this bill, if adequate consideration was involved.

You could, for example, as the Secretary of Labor has already said, buy or sell securities, or real property, or lend to a relative of a fiduciary. Relative means a spouse, brother, sister, half-brother, half-sister, ancestor, and a few others. You could buy or sell, or lease securities, or real property, or make loans to or with an officer of a union whose members are covered by the pension funds, since the term party-in-interest covers an officer of a union.

Well, some of the worst abuses occurred in that connection, but apparently you could do that if there was adequate consideration. You could make loans to an officer, or trade in securities with an officer of an employer whose employees were covered by the plan. You could buy or sell or lease securities or real property, or make loans to a union whose members were covered by the plan for adequate consideration.

As I see it, under this bill the trustees of a joint Taft-Hartley trust could lend funds to a union, so that it could finance an organizing drive, or they could lend funds to particular employers in the hope of affecting their collective-bargaining policies.

Senator NICKLES. May I interrupt. Let me ask a couple of questions, if I might, to all the panel, so that we can continue moving.

Mr. GORDON. I have obviously strayed beyond my allotted time. Nasty habit of mine.

[The prepared statement of Mr. Gordon follows:]

STATEMENT BY

MICHAEL S. GORDON

BEFORE THE

SUBCOMMITTEE ON LABOR

OF THE

SENATE COMMITTEE ON

LABOR AND HUMAN RESOURCES

ON

S.1541
SUBTITLE E - AMENDMENTS TO FIDUCIARY RESPONSIBILITY PROVISIONS
THE RETIREMENT INCOME INCENTIVES AND
ADMINISTRATIVE SIMPLIFICATION ACT

AND

S.1678
TO AMEND THE RETIREMENT INCOME SECURITY ACT OF 1974
WITH REGARD TO MORTGAGE INVESTMENTS

Tuesday, January 26, 1982

* * * * * * *

Mr. Chairman and members of the Subcommittee. My name is Michael S. Gordon. I am a partner in the law firm of Mittelman and Gordon, a Washington, D.C. law firm that, among other things, specializes in ERISA and the employee benefits field. During the period 1970-75 I served under an appointment by Senator Jacob K. Javits as Minority Counsel for Pensions for the U.S. Senate Committee on Labor and Public Welfare and participated in the drafting and legislative process that culminated in the enactment of ERISA. Prior to that time, I had served as the U.S. Department of Labor's Counsel to President Kennedy's Cabinet Committee on Corporate

Pension Funds, which issued a report in 1965 that recommended wide-spread regulatory reforms in the private pension field. In addition during 1972-1973 I also served as Minority Counsel to the U.S. Senate Select Committee on Small Business and helped to formulate and participate in a series of investigations pertaining to the federal paperwork burden on small business, which I believe was one of the original investigations into the subject.

I would like to commend the Chairman and Members of this Subcommittee for holding these as well as other hearings on S.1541, the Retirement Income Incentives and Administrative Simplification Act, and related legislation and express my appreciation for granting me this opportunity to appear and testify today. Although I disagree with certain portions of this bill -- and I would like to emphasize in this regard that the views I will be presenting are my own and should not be necessarily attributed to any of the clients of Mittelman and Gordon -- I believe it is entirely appropriate, and, indeed, essential that Congress continue to pay close attention to ERISA to determine whether it is functioning properly and fulfilling the important objectives it was intended to serve. Most of us, especially those of us who participated in the original drafting process of ERISA, would concede that a number of its provisions are less than satisfactory and that with the passage of time shortcomings have been exposed that deserve correction. This is a common problem with most pioneering legislation and ERISA is no exception.

Regrettably, I have concluded that despite some good features, substantial portions of S.1541 are so poorly drafted that the bill as a whole fails to eradicate the real flaws in ERISA that have been brought to light and will substantially increase other problems. Indeed, it is surprising that certain segments of the private pension industry have thrown their support to this bill. Having already shot itself in the foot by securing passage of the Multiemployer Pension Plan Amendments Act of 1980 (PL 96-364), it would seem that a natural instinct for self-preservation would instruct private pension plan sponsors to avoid any further self-inflicted wounds. No doubt S.1541 is well-intentioned but if it is enacted in its present form it will make advocates of the private pension system long for the palmy days when the original version of ERISA was still the law of the land.

One of the fundamental reasons why RIISA is destined to become another private pension industry-albatross is its proposal to weaken the rules governing conflicts of interest in pension funds which are found in Section 406 of ERISA and Internal Revenue Code Section 4975. No single ERISA provision has aroused more controversy or been more misunderstood and yet it remains one of the basic bulwarks of the law against conflict of interest abuse and corruption in pension funds. To water down these provisions on grounds of their alleged burdensomeness would be tantamount to inviting the return of the very abuses that triggered off the drive for private pension reform in the first place, and would cause millions of Americans to once again question the integrity of the private pension system. Exactly why conservative Republicans in the Congress should take the lead in making proposals that will encourage an unhealthy climate of permissiveness in connection with conflict of interest transactions is a total mystery to me.

Right now the confidence of the public in private pensions is at an all time high. Prior to ERISA it was at an all time low. One reason why confidence was restored was because people believed that Congress, by enacting ERISA, had enacted a tough law that would come down like a ton of bricks on persons who fooled around with private pension funds, no matter how clever or adroit their schemes or how carefully they camouflaged them, or how high up these persons stood in the corporate or union hierarchies that sponsored the funds. S.1541, on the other hand, appears to assert as its guiding premise, that ERISA is too tough on conflicts of interest, that it interferes too much with what Congressman John N. Erlenborn (R.Ill.) has referred to as the "commercial transactions which are the lifeblood of any employee benefit plan."

Congressman Erlenborn, the architect of H.R. 3445 and its counterpart in the Senate, S.1541, has been espousing this view for a long time. He was advocating it back in 1974 at the Senate-House conference on ERISA. The House had adopted the approach, promoted vigorously by Congressman Erlenborn, which would have approved of pension fund "insiders" (so-called "parties-in-interest") engaging in transactions involving the pension fund's assets, providing the transaction was for "adequate consideration". This is the same approach now set forth in S.1541 and H.R. 3440.

The Senate's version of ERISA, which ultimately prevailed, rejected the "adequate consideration" test as the basis for validating party-in-interest transactions. Instead, it barred party-in-interest transactions (except for a few types which were given statutory exemptions) unless the plan and the "insiders" benefiting from the transaction could demonstrate to the Secretary of Labor that the transaction was in the interest of the participants and beneficiaries, and contained adequate safeguards to protect their interests. It also had to be demonstrated that it was administratively feasible for the Secretary of Labor to lift ERISA's prohibition against the transaction.

Not only did the Senate-House conferees reject Congressman Erlenborn's approach to conflicts of interest in pension funds but so have three successive Administrations -- those of Presidents Nixon, Ford and Carter. Congressman Erlenborn pressed each of these Administrations to withdraw their support for ERISA's tough rules on conflicts of interest but each of them demurred. Congressman Erlenborn is now going for his fourth bite of the apple.

The reason why the "adequate consideration" approach has been so thoroughly repudiated up to now is simple -- so simple that it has occurred to every serious student of private pensions, regardless of their other views on ERISA or government regulation:

"Adequate consideration" does not work as a method of preventing conflict of interest abuses. We know this because prior to 1974 "adequate consideration" was the essential component of the Internal Revenue Code's regulations for checking conflict-of-interest abuse in tax-qualified pension plans, and had it worked under the Code it would have been totally unnecessary to even consider stronger measures in ERISA.

By proposing to return to the old Internal Revenue Code test of "adequate consideration", Congressman Erlenborn and his allies have chosen to ignore the historical evidence that linked the spectacular growth of conflict of interest abuse in private pension plans with the insufficient regulatory controls exercised under the Internal Revenue Code prior to ERISA. One reason for this may be that the House Labor Subcommittee never really investigated the subject as did both the Senate Government Operation's Subcommittee on Permanent Investigations and this Subcommittee throughout the 1960's and early 1970's. Starting in 1965 with Senator John McClellan's investigations into labor union racketeering and corruption, including pension fund abuses, and continuing with this Subcommittee's investigations in 1971 and 1972, numerous examples of party-in-interest corruption and abuse was brought to light, unchecked by the "adequate consideration" requirements of the Internal Revenue Code. Just to mention a few (and I am relying principally on my own recollection and personal notes I have kept), these included:

- Senator McClellan's Permanent Subcommittee on Investigation's exposure of the Allied Trades Council and Local 815 of the International Brotherhood of Teamsters in 1965 where it was found that both the unions and two welfare-pension funds were dominated by one George Barasch who managed to appropriate some $15 million in both trust and union funds to capitalize several corporations that he formed as well as establishing a management firm to administer the welfare-pension funds (for which he received an annual salary of $35,000, $407,000 in life insurance coverage and a pension benefit of $796,925). In addition, Barasch created several overseas research foundations into which various welfare-pension funds were channeled with diversions amounting to over $5 million. The Subcommittee concluded that then existing laws (which included the IRS prohibited transaction rules) were inadequate to prevent these abuses. See Senate Committee on Government Operations, Report of Permanent Subcommittee on Investigations, Diversion of Union Welfare-Pension Funds of Allied Trades Council and Teamsters Local 815, S.Rept. No. 1348, 89th Cong., 2d Sess. (1966).

- Although Jimmy Hoffa was convicted of mail fraud in 1964, the substantive charges of which he was convicted all involved transactions made in connection with the Teamsters Central States, Southeast and Southwest Area's Pension Fund. Among other things, the indictment charged that Hoffa and other defendants applied $100,000 of more than $1,000,000 in fraudulently obtained loan proceeds that they had received through the Pension Fund to repay debts incurred by Sun Valley, Inc., a Florida real estate corporation in which Hoffa had a substantial interest. Repayment of these debts enabled Sun Valley to extricate itself from reorganization proceedings under Chapter X of the Bankruptcy Act. Included among the Sun Valley debts that the loan proceeds assisted in repaying was $400,000 owed by Sun Valley to a Florida bank. Repayment of this Sun Valley debt enabled Hoffa to withdraw from the Florida bank $400,000 of Teamsters money which Hoffa had deposited in a non-interest-bearing account at the bank as security for the bank's $400,000 loan to Sun Valley. It should be noted that prior to ERISA the IRS did not take any action against the tax-exempt status of the Central States funds as a result of the foregoing arrangements.

- In 1962 Genesco, Inc. used its employee pension fund to acquire Flagg-Utica Corp., a knitwear manufacturing concern. Flagg-Utica wanted Genesco stock rather than cash for cash payment to its stockholders would have been taxable immediately. But rather than buy on the open market, Genesco dipped into the pension fund for 150,000 shares; it paid the fund $5,250,000, or an average between the high and low Big Board quotes on the day chosen for the transaction. By buying the stock from its pension fund, Genesco probably saved money; if the company had bought so heavily on the stock exchange the market price per share probably would have climbed, increasing the cost of the purchase. And because management controlled the fund, Genesco kept control of the $5,250,000; that sum remained available for further acquisitions. Subsequently, Genesco agreed with the SEC that it would restrict transactions in Genesco securities on behalf of its Employee Stock Bonus Trust and pension plan as well as restricting purchases by the Company from the stock bonus or pension plans during negotiations with other companies. Again, the IRS never sought to challenge the tax-exempt basis of the Genesco pension funds on the basis of the prohibited transaction rules in the tax regulations IRS that then existed. Subsequently, hearings before this Subcommittee disclosed that Genesco had used pension fund assets to finance similar corporate acquisitions, involving complex real estate leaseback transactions. Ultimately, some of these transactions resulted in serious losses to the plan. See Private Welfare and Pension Plan Study, 1971, Part II, Hearings Before the Subcommittee on Labor of the U.S. Senate Committee on Labor and Public Welfare, 92d Congress, 1st Session, at 599 et seq.

- In 1963, according to the Los Angeles Times and the Wall Street Journal, Rapid-American Corp. acquired McCrory Corp. which then was the fourth largest national variety store chain. When Rapid-American took over control of McCrory it also took over McCrory's pension fund. Mr. Meshulam Riklis was chairman of the board of both Rapid-American and McCrory. He and other officers who were trustees directed the pension fund to buy 93,318 shares of Rapid-American for the pension fund in 1964 despite the fact that during that year Rapid-American reported a loss of $6.7 million. On these shares the fund reported a paper loss of over $1 million during the following 12-month period. At the same time that Riklis and others were directing the pension fund to purchase Rapid-American stock, they were selling their personal shares in Rapid-American to the McCrory pension fund. It was later alleged in an unrelated law suit filed by J. Neal Dow, then a McCrory director, that the whole purpose of the pension-fund purchase was to artificially support the price of Rapid-American stock. See Los Angeles Times, Oct. 3, 1965, and Wall St. Journal March 16, 1966.

- In 1971, this Subcommittee heard evidence that the Winn-Dixie Corp., a large retail food store chain, administered its profit-sharing plan by permitting the plan's assets to be held in a private investment trust which had more than 28% of its holdings in real estate loans and mortgages in turn held by a real estate subsidiary holding corporatio owned jointly by the trust and the Winn-Dixie Corp. Officers and directors of Winn-Dixie were substantial borrowers from the investment fund to finance real estate acquisitions which in turn were leased by the officers and directors to Winn-Dixie for retail store premises or other purposes related to Winn-Dixie operations. See Private Welfare and Pension Plan Study, 1971, Part II, supra at 861 et seq.

Because of virtually unchecked conflict of interest transactions like the foregoing -- and there were many more examples, such as certain banks causing pension funds under their control to maintain investments in Penn Central in order to prop up the company and backstop the bank's creditor position with respect to funds they had lent to Penn Central -- the public perception of private pension plans steadily worsened and legal scholars and pension experts began to examine the situation more closely. They arrived at the almost unanimous conclusion that the prohibited transaction rules of the IRS (i.e., adequate consideration) were much too weak to curb the conflict-of-interest abuses that had been disclosed. For instance, an authoritative Minnesota Law Review article concluded that the IRS rules required strengthening, observing that:

> While the underlying principle of the tax rules governing the operation of employees' trusts is to insure that tax benefits are available only to trusts that protect the employees' interests, the Commissioner has, in practice, modified this approach. Instead of denying exemption to any trust dealing with the employer -- which a strict application of the exclusive benefit rule arguably requires -- the Commissioner has permitted such investments. If the trusts' dealings with the employer meet the standards of an arms length transaction, the trust may purchase the employer's stock, obligations or property. Instead of making annual cash contributions to the trust, the employer can contribute his stock, property or debt securities to the employees' trust. In addition, the employer may finance an expansion of his business by leasing the trust owned property from the employees trust. See 45 Minn Law Rev. 575 at 605-606 (1961).

A similar conclusion was reached in connection with joint labor-management Taft-Hartley funds where it was observed that the regulations under the Internal Revenue Code "have failed to be effective sources of regulation." See Issacson, Employee Welfare and Pension Plans: Regulation and Protection of Employee Rights, 59 Col. Law Rev. 96 at 105 (1959).

Even now, despite ERISA, the temptation of parties-in-interest to attempt to manipulate the assets of employee pension funds for their own personal or institutional advantage is very great, and especially great when funds for making capital investments or serving other corporate objectives are in short supply. Recently, two instances of such misconduct have been revealed, one involving the employee pension plan of the Grumman Corp. and the other involving the pension and profit-sharing plans of Harper & Row. In the first instance, a federal judge ruled last December, at the initiative of the Department of Labor, that the trustees of the Grumman pension plan had acted improperly in using assets of the plan to buy company stock to fend off a takeover. In the case of Harper & Row, the Department of Labor is currently investigating to determine whether trustees of the Harper & Row plans acted improperly in terminating the pension plan and amending the profit-sharing plan so it could use the assets to buy back a large block of stock held by the Minneapolis Star Tribune. Although Harper & Row was not threatened by a takeover, it allegedly felt vulnerable and this was the justification for its action.

In its editorial of January 4, 1982, the magazine Pensions & Investment Age, hardly an advocate of overwhelming pension fund regulation, headlined these actions by the Grumman and Harper & Row trustees as "Assets Raids: Inexcusable Piracy", and stated:

> As we have said before, pension funds should not be looked upon as pools of savings that the companies can raid as they see fit.
>
> Rather, they should be seen as pools of savings for the sole purpose of providing retirement benefits.
>
> If this is not clear in the Employe Retirement Income Security Act, then the law should be amended to make it clear.

Yet, S.1541 is designed to permit transactions between the plan and parties-in-interest even if the primary and perhaps the only reason for the transactions is to fend off a corporate takeover or because the plan sponsor feels vulnerable, as long as the transactions are for "adequate consideration."

Moreover, in its present form, S.1541 would permit, for adequate consideration (or, in the case of a loan, for adequate security and a reasonable rate of interest), fiduciaries of a pension fund to use assets of the fund to:

1. Buy or sell securities or real property or lend to a "relative" of a fiduciary, "relative" meaning (as amplified by Section 3103 of S.1541) a spouse, brother, sister, half-brother, half-sister, ancestor, lineal descendant or spouse of a lineal descendant.

2. Buy or sell or lease securities or real property or make loans to or with an officer of the union whose members are covered by the pension fund since the term "party in interest" is defined to include an officer of an employee organization any of whose members are covered by the plan.

3. Similarly, buy or sell or lease securities or real property or make loans to or with an officer of the employer whose employees are covered by the plan.

4. Buy or sell or lease securities or real property or make loans to or with a union whose members are covered by the plan, since the union is also a "party in interest". Thus, for example, with the receipt of adequate security and a reasonable rate of interest, the trustees of a joint Taft-Hartley trust could lend pension plan funds to a union so that it could finance organizing drives. Since contributing employers are also parties-in-interest the trustees could lend plan funds to such employers in the hope of affecting their collective bargaining policies.

5. Buy or sell or lease securities or real property or make loans to or with officers or employees of a bank or insurance company providing services to a plan because they too are parties-in-interest.

Frankly, the compilation of such a list could go on ad nauseum. Are these the kind of transactions which Congressman Erlenborn has referred to as "the lifeblood of any employee benefit plan"? Are the prohibitions against these kinds of transactions -- unless the parties can prove publicly to the Secretary of Labor that they are consistent with the best interests of the participants -- so "draconian"? Getting closer to home, would the members of this Subcommittee prefer that trust funds established on their behalf or on behalf of their children be subject to the currently tough prohibitions against conflict-in-interest dealing in ERISA or the weaker standards proposed under S.1541?

From an enforcement standpoint, the approach taken in S.1541 is a disaster. It would require a bureaucratic army on the scale of the old Ottoman Empire to police each of the potentially millions of party-in-interest transactions engaged in by employee benefit plans throughout the county during any particular year to determine whether they were made for "adequate consideration", met the exclusive benefit requirement (whatever that now would mean) and otherwise comported with the requirements of ERISA Section 404. Indeed, this is one of the very reasons why the IRS conceded in testimony before this Committee and others that the IRS could not adequately regulate the conflict of interest abuses then known to be taking place. See Welfare and Pension Plans Investigation, Hearings before the Subcommittee on Welfare and Pension Funds of the Committee on Labor and Public Welfare, U.S. Senate, Part 3, 84th Cong., 1st Sess., July 20, 1955, p. 847. Since no such bureaucratic army is feasible or desirable, if the approach to conflicts of interest advocated by the sponsors of S.1541 is adopted, the non-enforceability of the prohibited transactions provisions to party-in-interest transactions will soon be manifest and the provisions themselves will become a deal letter.

Mr. Chairman, [illegible] who work in the employee benefit plan field can afford to be insensitive to the hazards of over-regulation. There is absolutely no doubt in my mind that excessive, unnecessary regulation will kill off the private pension system to the everlasting detriment of countless numbers of American workers who depend on these plans and would cause great harm as well to the nation's economy. At the same time, we cannot be oblivious to the consequences of failing to deter adequately conflict of interest abuse and corruption in these plans. That failure will also utterly destroy the further potential for growth in the private pension system because of the resulting public cynicism and distrust.

The current prohibited transaction provisions in ERISA along with the exemption procedure provide the appropriate regulatory balance of these competing concerns. If these provisions err on the side of strictness, that is the way it should be. Nonetheless, it is my impression that within the last two years Labor Department officials have succeeded in mastering the exemption procedure, speeding it up and finding additional techniques to accomodate various problems that have arisen. There is no reason why this progress cannot continue, and no evidence, and I emphasize this, why any problems, whether they involve banks or insurance companies or any other parties-in-interest cannot be successfully resolved within the framework of these procedures.

In any event, none of the alleged problems afflicting service providers should be used as an excuse to open the door once again to the most flagrant type of conflict of interest abuses. Nor, I should add, is it appropriate to provide, as S.1541 apparently does, that the exemption authority granted to the Secretary of Labor can be used to even waive the "adequate consideration" criteria otherwise proposed by S.1541. In short, rather than encourage those who view pension plans as tempting targets for furthering business schemes extraneous to the underlying interests of pension plan participants and beneficiaries, this Subcommittee should, in the bipartisan footsteps of its predecessors, do everything reasonably possible to eliminate the predatory activities of pension fund "insiders". The guiding principle should remain Chief Judge Cardozo's famous observation in Meinhard v. Salmon, quoted recently with approval and emphasis by Federal Judge Mishler in the Grumman case:

> Many forms of conduct permissible in a workaday world for those acting at arm's length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompounding rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. Wendt v. Fischer, 243 N.Y. 439, 444, 154 N.E. 303. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.

And I hope it will not consciously be lowered by any judgment of this Subcommittee.

My final comments concern Section 3508 of S.1541 and S.1678. These proposals are not linked substantively but it is useful to consider them together since, in my view, they both manifest symptoms of the same disease -- the disease being the belief that private pension trust funds can and should be used to ameliorate conditions or problems in the nation's economy even though these conditions or problems are not caused by the trust funds themselves.

In the case of proposed Section 3508, S.1541 provides a special statutory class exemption for loans or leases made by a defined contribution plan to a major employer establishing and maintaining the plan. Up to 50% of plan assets could be used to make such loans and leases. According to Congressman Erlenborn, the original author of this provision, its purpose is to "eliminate present barriers to plan expansion and to spur capital formation." (Emphasis supplied)

In the case of S.1678, authored by Senator Orrin G. Hatch (R.Utah), the prudent investor standards in ERISA would be modified to permit private pension trusts to invest in residential housing mortgages so long as they yielded a reasonable rate of return, with "reasonable" being defined as a rate which equals, at least, the average net yield of all plan investments for the preceding ten years or any consecutive three year period therein or "is consistent with other rates of return on similar investments." Obviously, this proposal is designed to encourage pension funds to pump their assets into the distressed home mortgage industry.

The objectives behind both Section 3508 and S.1678 are undoubtedly praiseworthy but the techniques suggested to attain those objectives are atrocious. Pension trust participants and beneficiaries are entitled to receive the benefit of the most profitable investments that can be made discounted by risk. Yet both Section 3508 and S.1678 would subordinate the profitability objective to the objectives of assisting the business expansion program of an employer or rendering assistance to the ailing housing industry. In both instances, these extraneous pension fund objectives may result in a use of plan assets which is less secure and less profitable than other investments available on the market. Whatever ultimate advantages may be derived by the fund's beneficiaries from Section 3508 and S.1678 they would be too attenuated to compensate for the beneficiaries' loss of income. For these reasons, the proposals involved should be abandoned. They would establish dangerous precedents which would interfere greatly with the effectiveness of ERISA's fiduciary standards.

Senator **Nickles**. We appreciate your input. I am not sure if you can be forgiven for all of the—I am kidding. But I do appreciate, Mr. Gordon, your insight, as you have worked on the creation of this legislation.

I started to say monstrosity, and I did not say that, I said legislation. But I will ask a couple of questions for the general panel.

All of you heard, and I think a couple of you mentioned in your statement, the obvious lack of, or regret, or delay in granting the exemptions.

What is your comment on the exemptions that were announced by the Secretary today, and do you feel like those are going too far, or not far enough? Is that a step in the right direction or a step backward?

Mr. **Gordon**. Well, I will give you my reaction. I think they move in the right direction. I think that is the kind of thing that the exemption framework was intended to accomplish. It was realized that there were all kinds of transactions which technically would fall within the prohibited area, but for which the administrative relief was justified.

I feel that one of the large problems in this area is the fact that the party-in-interest prohibitions cover service providers to the extent that they do. I feel one of the reasons for delay is the fact that the Secretary of Labor, and the Department, is not all that, shall we say, familiar with the practices of the banks and the insurance industry, and so on. They are more accustomed to dealing with the welfare and pension plans themselves, or labor organizations, and I think that this does present a problem in terms of time, in trying to master the sheer background and complexity of these matters.

I would suggest, and this may seem radical, but there is a provision in section 506 of ERISA which authorizes the Secretary of Labor to make arrangements for agreements with other Federal agencies, and also with any State agency, for purposes of helping to administer this law.

Now, I see no reason why the problems presented by service providers, particularly insofar as they connect up with banks and insurance carriers, could not be handled by the Federal or State banking agencies under some form of delegation by the Secretary of Labor, and could not also be handled by the State insurance commissioners in that regard. I see no reason why they could not apply ERISA as correctly as the Secretary of Labor.

Senator **Nickles**. Do either of the other gentlemen have a comment on that?

Mr. **Zaleznick**. I think, Senator, we would strongly support the objectives of the Secretary of Labor, and we would like to take a look at some of the specifics of his proposal. Hopefully that would be the way to go.

Senator **Nickles**. You do not need to make a formal position.

Mr. **Bruce**. Just a general comment. The kinds of problems that are legitimate in this area can be taken care of through the exemption process. What bothers me is when we get into the bidding process, like we saw this morning, whether an exemption will get out next month or next week.

I think an additional concern is that all the information, all the input on the class exemptions, is going to be coming from the people who are supposed to be regulated. The professional asset managers, so-called, are the people providing all the information. There are no outside parties. There are no disinterested experts to counterbalance the information being supplied. You can see the kinds of statistics that people come up with in some of the testimony that we heard today. Estimates of $25,000 to process an exemption, not backed up by any facts.

Senator NICKLES. How much do you think it might cost if you were fighting a class action, or fighting for a class action exemption, that took anywhere from 2 years?

Mr. BRUCE. The estimate was supposed to be for an individual exemption, and our understanding there is that most individual exemptions can be processed by nonlawyers. The process is not supposed to be difficult. If it is anywhere as near difficult as it is being made out to be, the subcommittee should be looking into right now. Because if the transaction is legitimate, if the consideration is adequate or advantageous to the plan, it should not be costing plans anywhere near that amount of money to get a ruling.

Senator NICKLES. Let me ask you another question. I am agreeing with you. I would hate to think that it would cost that much, but I can see where it would, because time is money, and every time that you have to process letters, or make an appearance, you are talking about a substantial amount of time in investments.

On that, would you agree with possibly some of the statements that have been made by many today? I see where you are coming from today, you do not want to eliminate the parties-in-interest cost.

Do you agree with many of the contentions that have been made, that maybe the parties in interest have by statute, been made too broad?

One case I think was mentioned that could extend to 100,000 parties in interest, over a transaction.

Mr. BRUCE. I have never seen any verification of that, and one point that should be made on the pooled separate account is that there is an existing class exemption for plans that put in less than 5 percent of the pooled separate account. The people associated with the corporate and union sponsors for those plans are not considered parties in interest.

So getting the 100,000 estimate, almost necessarily involves ignoring existing class exemptions.

Senator NICKLES. Ignoring, or taking them?

Mr. BRUCE. Ignoring, to come up with the figure of 100,000. Because if you had 20——

Senator NICKLES. I agree that the practical result is ignored in that type of degree, because it would be uneconomical, in any case.

Mr. BRUCE. My understanding is that under the class exemption, if a pooled account has more than 20 plans with assets in the pooled separate account, and no one of those plans has more than 5 percent of the pooled separate account funds, then there would be no parties in interest, except for the insurance company employees, officers, directors, and so forth.

Mr. GORDON. Senator, if I may, I would like to point out maybe three things.

First, I think if you will look at the time problem, that it mainly concerns class exemptions, and mainly for service providers, which goes back to my original point, that there is some way to deal with that independently, of waiting for the Labor Department to have to wade through the intricacies of those particular problems, that might be a useful approach.

Second, in terms of the vast numbers of parties in interest, this huge network that nobody can find out about—well, let me point out, all the law requires is that a reasonable effort be made to find out.

If an innocent mistake is made, under the existing exemption procedure, a party can apply for an exemption, and he can apply for it retroactively, and there are petitions pending before the Labor Department, there have been for some time, and there have been those that have been granted retroactively.

I do not think that the——

Senator NICKLES. Is that not technically a violation of law?

Mr. GORDON. But the Department has taken what amounts to a fairminded point of view. Someone was in the process of committing or committed a party-in-interest violation, without maybe fully realizing it. They go ahead and they apply for an exemption, they bring it to the public view and they ask to see whether or not there is really anything wrong with it. If the Department decides there really is not, they can apply it retroactively, and cure the technical violation.

Now, if that is not clear in the law, then it ought to be made clear in the law. But I do not think that there is any real serious problem about inadvertent violations. I think there is a much more serious problem about engaging in the kind of transactions which cause a great deal of trouble, in trying to decide how to come out on one side or the other in terms of whether or not to grant an exemption. I think that is a real problem, and finally, one point, earlier this afternoon an argument was made that one could repeal entirely section 406, and rely——

Senator NICKLES. Section 406 or 406(a)?

Mr. GORDON. Section 406(a), and rely on the exclusive purpose rule in section 404, with the prudent man rule, and diversification rule. I have to question that. If you rely solely on the exclusive purpose rule, arguably every party in transaction would be disloyal, and therefore, under the exclusive purpose rule it would be invalid. So if you leave the exclusive purpose rule alone and you repeal section 406(a), then, as I see it, the law will be interpreted to mean that every party-in-interest transaction could fall within 406(a) and be invalid, because technically it is benefiting somebody else besides the plan, some other institution or person who is a party in interest. That is the problem. That is the reason why section 406(a) was drafted the way it was.

Senator NICKLES. Is it your contention that the prudent man rule still would not be sufficient to cover those under 404?

Mr. GORDON. A transaction can be perfectly prudent, and still disloyal, and the whole purpose of the old common law rule against conflicts of interest, which is contained in the exclusive purpose rule, is not to deal with a particular transaction as such, which may be prudent. It may be that in most instances it would be prudent. It is designed to prevent the trustees and other fiduciaries from falling into the path of temptation, so to speak, realizing at some point they are only human, and their conflicting loyalties may take over, and cause them to do something which at some particular juncture is not prudent.

Senator NICKLES. Gentlemen, we appreciate your input and expertise, and again, I would like to ask you to be receptive if there are additional questions coming from myself or other members of the committee.

Thank you very much.

On our final panel, we have Douglas Johnson, Mortgage Bankers Association of America; Steven Doehler, Mortgage Insurance Companies of America; and Stuart M. Lewis, National Association of Home Builders.

Gentlemen, welcome—and women.

Mr. Johnson, would you care to begin?

STATEMENTS OF DOUGLAS E. JOHNSON, VICE PRESIDENT FOR CORPORATE PLANNING, CHASE HOME MORTGAGE CORP., MONTVALE, N.J., ON BEHALF OF THE MORTGAGE BANKERS ASSOCIATION OF AMERICA; STEVEN P. DOEHLER, STAFF VICE PRESIDENT, MORTGAGE INSURANCE COMPANIES OF AMERICA; STUART M. LEWIS, ESQ., SILVERSTEIN & MULLENS, WASHINGTON, D.C., ACCOMPANIED BY DEBORAH I. MILLER, ON BEHALF OF THE NATIONAL ASSOCIATION OF HOME BUILDERS, A PANEL

Mr. JOHNSON. Mr. Chairman and members of the subcommittee, my name is Douglas E. Johnson. I am vice president of Chase Home Mortgage Co., of Montvale, N.J. I am testifying today in my capacity as chairman of the New Investor Opportunities Subcommittee of the Mortgage Bankers Association of America.

We appreciate the opportunity to appear before you to testify on the desirability of pension fund investment in mortgages, and in support of the intent of amendments to the Employee Retirement Income Security Act—ERISA—to encourage such investment, as is provided for in S. 1541, introduced by Chairman Nickles, as well as in S. 1678, introduced by Senator Hatch, who is also a cosponsor of S. 1541.

Each of these bills reflects a growing awareness that ERISA, as interpreted by the Department of Labor, DOL, has had the effect of inhibiting pension plan trustees and pension plan managers from making investments in home mortgages and other securities that can provide attractive returns for pension funds and provide the diversity that prudent investing and ERISA require.

Our written statement discusses MBA's specific views of these legislative measures, but we do have two additional suggestions: First, section 3505 of S. 1541 would rewrite the prohibited transactions section of ERISA so as to prohibit only those transactions where the plan would receive less than adequate consideration, either in the form of money or property. Such a market-oriented test is a vast improvement over the current flat prohibition. However, to allow the natural course of pension investment in mortgages to develop fully, the test should be clear and certain. Either by statutory provision or other legislative history, Congress should express its intent that "adequate consideration" does not mean the highest yield or lowest price obtainable, but rather, means one which is not unreasonable under the circumstances.

Second, section 3511 of S. 1541 would clarify that assets in a pooled separate account are not "plan assets" for purposes of applying the prohibited transaction rules. The concept is a good one and it should be applied to mortgage finance as well. As is explained more fully in our written statement, one aspect of the mortgage banking function is to issue securities backed by pools of mortgages. Pooled mortgages share the same characteristics as other assets in pooled separate accounts, and the relief of section 3511 from the burden of tracing beneficial interests should extend to them as well.

Fundamental changes that are occurring in the way housing is financed in this country should present new investment opportunities for pension funds. A combination of factors has severely reduced the effectiveness of the old mortgage finance system which relied heavily on mortgage investments by savings and loans and other depository institutions.

While in the future, thrifts may specialize in consumer and/or real estate lending, they may not hold long-term loans. such as mortgages, in portfolio to the extent they have in the past. This will create a home financing gap. Mortgages must be packaged and sold to pension funds and others with sources of long-term funds in order to bridge this gap.

Mortgage investment and investment vehicles are evolving rapidly to bridge this gap. We cannot know today what particular form future mortqage investments might take. We feel that the class exemption process cannot respond to this kind of change. ERISA and its exemption process are a real cost to the mortgage process.

Public pension funds, for example, those serving State and local government employees, are becoming increasingly important investors in residential mortgages. The Federal Reserve Board reports that such funds made net mortgage investments of $190 million in 1976, $679 million in 1978, and $1.3 billion in 1980. However, private pension fund investment is so small as to be virtually nonexistent.

The "prohibited transaction" rules of ERISA, as interpreted by the Department of Labor, create a number of unnecessary barriers to mortgage investment by private pension funds. MBA recommends that these barriers be eliminated through administrative and legislative changes so that it is possible and practical for funds to invest in residential mortgages.

I would be happy to respond to any questions you may have.

[The prepared statement of Mr. Johnson follows:]

STATEMENT OF DOUGLAS E. JOHNSON

Mr. Chairman and Members of the Subcommittee, my name is Douglas E. Johnson. I am Vice President of Chase Home Mortgage Company, of Montvale, New Jersey. I am testifying today in my capacity as Chairman of the New Investor Opportunities Subcommittee of the Mortgage Bankers Association of America.* Appearing with me is William E. Cumberland, MBA's General Counsel.

We appreciate the opportunity to appear before you to testify on the desirability of pension fund investment in mortgages, and in support of the intent of amendments to the Employees Retirement Income Security Act (ERISA) to encourage such investment, as is provided for in S 1541, The Retirement Income Incentives and Administrative Simplification Act of 1981, introduced by Chairman Nickles, as well as in S 1678, amending the Employment Retirement Income Security Act of 1974, introduced by Senator Hatch, who is also a co-sponsor of S 1541. Each of these bills reflect a growing awareness that ERISA, as interpreted by the Department of Labor (DOL), has had the effect of inhibiting pension plan trustees and pension plan managers from making investments in home mortgages and other securities that can provide attractive returns for pension funds and provide the diversity that prudent investing, and ERISA, require.

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*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership comprises mortgage originators, mortgage investors, and a variety of industry related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate investment portfolios. Members include:

- Mortgage Banking Companies
- Mortgage Insurance companies
- Life Insurance companies
- Commercial Banks
- Mutual Savings Banks
- Savings and Loan Associations
- Pension Funds
- Mortgage Brokers
- Title Companies
- State Housing Agencies
- Investment Bankers
- Real Estate Investment Trusts

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MBA and the real estate finance industry applaud these efforts and urge the Congress to continue along the path of encouraging sound and diverse pension fund investment in the housing market.

Section 3505 of S 1541 would rewrite the prohibited transactions section of ERISA so as to prohibit only those transactions where the plan would receive less than adequate consideration, either in the form of money or property. This would appear to free all transactions that are consistent with other similar transactions in an active nationwide, or even regional, market, because the adequacy of the consideration could be measured by the market. Such a market-oriented test is a vast improvement over the current flat prohibition. However, to allow the natural course of pension investment in mortgages to develop fully, the test should be clear and certain. "Adequate consideration" needs a definition on which pension fund managers can rely without the threat that the Department of Labor will subsequently decide that a particular investment did not meet an undefined standard. Either by statutory provision or other legislative history, Congress should express its intent that "adequate consideration" does not mean the highest or lowest price obtainable, but rather means one which is not unreasonable under the circumstances.

Section 3511 of S 1541 would clarify that assets in a pooled separate account of an insurer or assets in a collective investment fund of a bank or similar institution supervised by the United States or a state, are not "plan assets" for purposes of applying the prohibited transaction rules. The concept is a good one and it should be applied to mortgage finance as well. As is explained more fully later in this statement, one aspect of the mortgage banking function is to pool mortgages and issue securities backed by the pool of mortgages. Section 3511 should be amended to exclude from the assets of a pension plan mortgages in a mortgage pool of a financial institution or business organization regularly in the business of issuing mortgage-backed securities. Pooled mortgages share the same characteristics as other assets in pooled separate accounts, and the relief of Section 3511 from the burden of tracing beneficial interests should extend to them as well.

S 1678 establishes that residential mortgage investments that provide a "reasonable rate of interest" would satisfy the fiduciary duties requirements and would be exempt from the prohibited transaction rule. However, reasonable rate of interest is defined to be the rate of interest that equals or exceeds the average net yield to the plan for the preceeding 10 years (or any consecutive 3 years within such 10-year period) or is reasonable in light of the investment circumstances at the time. While this approach might seem appealing to the housing finance industry during times when interest rates are rising, it could cause mischief if interest rates drop over a period of several years. Furthermore, as applied to the test of fiduciary duties, the provision could be interpreted as approving investments in mortgages at rates that met the statutory average net yield requirement but which no prudent investor would touch. So interpreted, such an amendment could invite a return of the abuses and favoritism that led to the enactment of ERISA. We suggest that S 1678 be substantially modified if it is to be enacted.

Fundamental changes that are occurring in the way housing is financed in this country should present new investment opportunities for pension funds. A combination of factors has severely reduced the effectiveness of the old mortgage finance system which relied heavily on mortgage investment by savings and loans and other thrift institutions. While in the future, thrifts may specialize in consumer and/or real estate lending, they will not hold long-term loans, such as mortgages, in portfolio to the extent they have in the past. This will create a home financing gap. Mortgages must be packaged and sold to pension funds and others with sources of long-term funds in order to fill the gap.

The demand for housing that is expected to occur in the 1980s will require a tremendous amount of capital. At the end of 1980, outstanding mortgage debt in the United States stood at $1.1 trillion. By 1990, that amount is expected to triple. Raising this volume of funds will require that mortgages be attractive to those who make long-term capital investments, such as pension trustees and managers.

Pension funds control an increasing share of American capital and so, must be tapped if sufficient funds are to be made available to housing. In addition, because they consist of stable long-term funds with an obligation to pay an annuity in the future, pension funds are ideally suited to mortgage investment. Public pension funds, i.e., those serving state and local government employees, are becoming increasingly important investors in residential mortgages. The Federal Reserve Board reports that such funds made net mortgage investments of $190 million in 1976, $679 million in 1978, and $1.3 billion in 1980. However, private pension fund investment is so small as to be virtually non-existent.

ERISA, which covers private, but not public, pension funds, creates a number of unnecessary barriers to mortgage investment. MBA recommends that a first step is to eliminate these barriers through administrative and legislative changes so that it is possible and practical for funds to invest in residential mortgages.

ERISA PROVISIONS

ERISA was enacted in response to well-documented and well-publicized abuses of their powers by trustees and others in positions to direct the use of pension plan assets. In establishing a nationwide, explicit test of fiduciary duty, and clarifying who are fiduciaries subject to the test, ERISA has worked well to encourage widespread responsibility in the pension field. These standards, especially the "prudent man" rule, were an incorporation of a variety of related standards that had been developed and tried over the years in the common law of the several states.

ERISA also introduced a novel approach to protecting pension beneficiaries from self-dealing and favoritism by those in positions to direct the use of plan assets. The "prohibited transactions" section of ERISA, Section 406 (29 U.S.C. 1106), has little legislative history and no widely used and developed antecedents. This section provides:

"PROHIBITED TRANSACTIONS"

"Sec. 406. (a) Except as provided in section 408:

(1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect—

- (A) sale or exchange, or leasing, of any property between the plan and a party in interest;
- (B) lending of money or other extension of credit between the plan and a party in interest;
- (C) furnishing of goods, services, or facilities between the plan and a party in interest;
- (D) transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan; or
- (E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 407(a).

(2) No fiduciary who has authority or discretion to control or manage the assets of a plan shall permit the plan to hold any employer security or employer real property if he knows or should

know that holding such security or real property violates section 407(a)

(b) A fiduciary with respect to a plan shall not—
  (1) deal with the assets of the plan in his own interest or for his own account,
  (2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or
  (3) receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

(c) A transfer of real or personal property by a party in interest to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a party-in-interest placed on the property within the 10-year period ending on the date of the transfer.

The general fiduciary duty approach of the Act rests on the assumption that pension managers can and should perform their trust by exercising their sound judgment in the best interests of the pension plan. In contrast, the prohibited transaction approach rests on the assumption that pension managers cannot and should not perform their trust by exercising their sound judgment in the best interests of the pension fund. It specifically prevents that exercise in a broad range of circumstances. The transactions prohibited by Section 406 are categorical and are not permitted by the Act, even if they would otherwise be in the best interests of the pension fund, or are routinely performed by other asset managers.

It is this observation that is so frustrating for those involved in home finance. The mortgage market is well established and active. It is a market that allows an investor or a pension plan trustee to measure the prudence of an investment against the investment decisions of other experienced investors. Yet ERISA effectively interferes with pension fund involvement in both the financing of new construction and in the financing of the purchase of existing, or older housing.

Financing for residential building projects generally occurs in two phases: short-term loans to the project developer to pay for the cost of construction; and long-term loans to the purchasers of the residential units, the proceeds of which are used to pay for those units. The developer pays off the short-term construction loan with the proceeds of the sales of the units.

Before a lender will make a construction loan, it must be satisfied that long-term financing for purchasers of the units will be available when the units are ready for sale. Generally, such a lender, if it does not intend to provide the long-term financing itself, will require a commitment from another lender obligating the second lender to make such long-term financing available. Once a satisfactory commitment has been obtained, the construction loan will be made.

Often a developer seeking a short-term construction loan will contract a company that specializes in obtaining commitments for long-term financing—a mortgage banker. The mortgage banker first makes a determination as to the feasibility of the proposed project. If that determination is favorable, the mortgage banker will agree to attempt to obtain a commitment for long-term financing. The mortgage banker usually looks to financial institutions or institutional investors.

The investor usually issues a written commitment to provide long-term financing or to buy mortgages from a mortgage banker and, after the units are completed, makes long-term loans to purchasers of the units, or buys the mortgages originated by the mortgage banker. Long-term investors include insurance companies, commercial and mutual savings banks, savings and loan associations, and the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC), the two federally chartered instrumentalities whose purpose is to support an orderly mortgage market and pension funds. A commitment is made for a specific time period, and a fee is usually charged by the investor.

Under a typical commitment, an investor obligates itself to provide a specific amount of long-term loans to purchasers of dwelling units who qualify under the investor's mortgage loan guidelines. In a case where the mortgage banker makes the commitment to provide long-term financing, the investor will obligate itself to purchase a specific amount of mortgages originated by the mortgage banker, provided that those mortgages meet the guidelines. The terms of the loans, such as the amortization period, the rate of interest, the percentage of value loaned, the requirements for loan qualification, the credit worthiness of the borrower, and the quality of the security, are set by the investor.

Usually, when an investor buys mortgages from the mortgage banker, the investor leaves with the mortgage banker the responsibility for collecting the monthly payments from the borrower, paying real estate taxes and hazard insurance premiums, and otherwise administering the loan. This function is performed for a fee and is called "servicing." Servicing fees are an important source of income for mortgage bankers.

The above explanation describes two markets for long-term mortgages. The "primary market" is the market in which the homebuyer obtains a mortgage loan, whether directly from an investor or from a mortgage banker.

The sale of the mortgage to an investor occurs in what is called the "secondary market." The secondary market also operates in a similar way to finance the purchase of existing, or older, housing. No construction loan is involved, of course, and the length of time a commitment to purchase the mortgages is outstanding is generally shorter. In fact, mortgage bankers sometimes agree to originate mortgages on existing housing without having a commitment from an investor, taking a chance that the mortgage can be sold after it is originated.

A variation on this basic way in which mortgage investors acquire mortgages as assets is the rapidly expanding market for securities issued by mortgage bankers and other loan originators based on a collection, or pool, of mortgages originated or otherwise obtained by the issuer. The most popular of these mortgage-backed securities are those whose scheduled payments of principal and interest are guaranteed by the Government National Mortgage Association (GNMA); a part of the Department of Housing and Urban Development (HUD). The mortgage-backed security device allows an investor to own a small portion of a large number of mortgages and thereby diversify risk and simplify accounting. Mortgage-backed securities are also generally more liquid than whole mortgages, that is, mortgages that are not part of a pool whose ownership is shared by several investors.

ERISA BARRIERS

If a pension fund wanted to be an investor in the mortgage markets as they now function, a violation of one or more of the prohibited transactions provisions of ERISA might arise due to a possible relationship between a pension fund and certain parties involved in the transactions. Fitting the definition of party in interest in Section (3) (14) of ERISA would be: a mortgage banker or other loan originator who is providing loan administration services on loans previously originated or purchased by the plan (a servicing mortgage banker); a developer of a project or a builder involved in the construction of the dwelling units who employs persons covered by a multiemployer plan; and an individual seeking a loan in order to purchase a dwelling unit may be party in interest under, among others, section (3) (14) (H) of the Act, by reason of being an employee of an employer, a service provider, or a union that is related to the plan.

Therefore, possible violations may arise in several phases of the above described transactions: The exchange of a loan commitment for a loan fee between a pension fund and a servicing mortgage banker may give rise to a violation of section 406(a) (1) (A) and (D) of the Act. A commitment by a pension fund to make loans or purchase mortgages, the proceeds of which will be used to purchase units developed and/or to be built, in whole or in part, by a contributing employer with respect to the fund, might arguably give rise to a violation of section 406 (a) (1) (B) and/or (D) of the Act. It should be noted, in this respect, that the Department of Labor has expressed its view that a transaction involving similar possible violations; i.e., the provision of a construction loan by a plan to an unrelated party who contracts with a contributing employer to do the construction, would not, in itself, constitute a prohibited transaction under section 406 (a) of the Act. If, in the case described in (ii) above, the employer is a fiduciary with respect to the fund, the mere involvement of the employer as a developer or builder might, in itself, be characterized as a technical violation of section 406 (b) (2) of the Act.

The purchase of a mortgage by a fund from a servicing mortgage banker, or a direct loan by a fund, the proceeds of which loan are used to purchase a dwelling unit, which purchase results in the repayment, in whole or in part, of a construction loan to a servicing mortgage banker, might give rise to a violation of section 406 (a) (1) (A) and (D) of the Act. If the proceeds of a direct loan or a loan purchased by a pension fund are used to purchase a unit developed and/or built, in whole or in part, by a contributing employer, such loan or purchase might be characterized as a violation of section 406 (a) (1) (D) of the Act. A direct or indirect (through the purchase of a mortgage) loan by a pension fund to a purchaser of a dwelling unit who is an employee of a contributing employer, service provider, or related union might give rise to a violation of section 406 (a) (1) (B) and (D) of the Act. Although section 408 (b) (1) of the Act may provide an exemption for such loans from a plan to persons who are participants and beneficiaries with respect to the plan, there is no relief for such loans to employees of service providers or unions that are related to the plan. The provision of additional loan administration services by a servicing mortgage banker might give rise to a violation of section 406 (a) (1) (C) and (D) of the Act. However, the statutory exemption provided in section 408 (b) (2) of the Act appears to permit such transactions.

This list is, by no means, intended to be exhaustive. It is illustrative of the problems and dangers pension fund managers face if they try to enter the mortgage market. The effect is to inhibit the entry of pension funds into the area of housing finance.

EXEMPTION RELIEF

The mechanism ERISA establishes for providing relief from the prohibited transaction rule where it is overly restrictive has not worked efficiently for housing finance. Under Section 408 of the Act (29 USC 1108), the Secretary of Labor has authority to grant exemptions for classes of fiduciaries or classes of transactions. The Secretary has issued a class exemption with regard to mortgage-backed securities (Prohibited Transaction Class Exemption 81-7, January 18, 1981) and has proposed for comment a class exemption for whole mortgages (46 Fed. Reg. 58773, Dec. 3, 1981).

The Mortgage Backed Security Exemption

The class exemption regarding certain mortgege-backed securities was welcomed by the housing finance industry. The exemption allows, under specified conditions, transactions between plans and parties in interest involved in the origination, servicing, and administration of certain types of mortgage pool investment trusts and the acquisition by plans of certain mortgage-backed securities. It does not address all types of mortgage pools and mortgage-backed securities, however, and it took several years and substantial expense to have the Department issue the exemption.

While the Department of Labor was considering its rule, which clears the basic immediate purchase and sale of securities backed by first lien mortgages, the market was developing more sophisticated variations that offer better investment opportunities. As the President's Commission on Housing noted in its January 6, 1982 preliminary report, the exemption does not specifically authorize contracts for forward delivery of mortgage-backed securities. An agreement to sell or purchase at some forward date at a price fixed now allows the issuer to originate loans for inclusion in the pool backing the security with a knowledge of what the future price for the security will be. A mortgage banker thus can set its lending price in the primary market, where it makes loans to homebuyers, based on the price it will receive in the secondary market when it sells the loan using the device of the mortgage-backed security.

Also absent from the exemption are mortgage pools composed of junior lien mortgages. Second mortgages are increasingly being used to finance the purchase of houses without paying off the low interest rate first mortgage on the house. Nor does the exemption include shared appreciation mortgages, an increasingly attractive instrument in which the investor shares with the borrower in whatever equity appreciation the property enjoys.

The Pending "Whole Mortgage" Exemption

The "whole mortgage" exemption was requested in 1980. It is now pending for comment. It has serious flaws.

In part I of the proposed exemption , subsection A would limit the mortgage financing to purchasers of new single-family residential dwelling units. While MBA has no objection to construction-related pension funds implementing a new home requirement, such a requirement should not be generally mandated. Mortgages on existing housing offer the same excellent investment opportunity as mortgages on new housing and should not be discriminated against on a broad basis. Construction-related pension funds should also keep in mind the importance of a viable resale market in existing houses, since the majority of new home purchasers "trade up" from an existing home.

Part I of the proposed whole loan exemption, unlike its mortgage pool investment trust counterpart (part I, subsections C and D), fails specifically to address mortgage loan servicing transactions. These transactions were included in the mortgage pool exemption because of the possibility that a pool sponsor, such as a mortgage banking firm, providing servicing for the loans that it sold to a plan, could technically come within the definition of a party in interest, and would thus be prohibited from making any subsequent loan sales to the plan. In view of the fact that the servicing of whole loans might also come within the definition of a "party in interest," and because we do not feel that a subsequent sale of mortgage assets by a mortgage servicer can properly be considered "incidental to the furnishing of such service," a specific mention of loan servicing transactions should be included in the whole loan class exemption.

In part II of the proposed exemption concerning conditions that apply to the transactions described in part I, subsection C requires that the decision to issue the commitment to purchase mortgages must be made on behalf of the plan by an established financial institution. Although a pension fund should have the discretion to retain a financial institution (meeting the criteria established in this subsection) to advise the plan on potential mortgage investments, it is equally important to allow a pension fund to make this decision itself. To ensure competitiveness in offerings, it would be most desirable for the financial institution originating the loans to make the presentation directly to the plan. Using this method, the plan can select among proposals presented from a variety of mortgage originators, thus assuring the competitiveness of these proposals. MBA, therefore, recommends that the "third party" investment decision requirement be dropped from the proposed regulation, or at least reduced to a suggestion.

Perhaps a more viable approach to the third party investment decision issue could be found by adopting the mortgage pool class exemption's provision (part I, subsections A (1) and B (1) regarding such decisions. That exemption requires a third party decision when the sponsor of the pool is also a fiduciary with respect to the plan. In cases where the pool sponsor is only a party in interest, no such third party decision would be required. Such a compromise would provide adequate protection in cases where self-dealing could be a problem, while allowing the fullest measure of competition in all other instances.

Subsection E of part II would limit the exemption to transactions involving first liens, and would therefore exclude second liens on single-family residential properties, a very important segment of the residential mortgage market and a high yielding investment for pension funds. Properly underwritten, fully amortizing second mortgages can offer investors a very attractive combination of safety, high yield, and short maturities, and should be permitted to allow for a fuller diversification of funds' asset portfolios.

Subsection B of part III (Definitions) narrowly defines an "established financial institution" as "an investment manager described in section 3(38) of ERISA with respect to the plan;" or a Federal savings and loan association. We believe that this narrow definition results in two major problems. First, this definition fails to include such established financial institutions as mortgage bankers, mutual savings banks, and state chartered savings and loan associations. Thus, no mortgages originated by these groups can be sold to the plan. The exclusion of these major lending groups would result in a reduction of competition among lenders for plan commitments, which may result in increased costs. Second, the exemption in general, and the proposed definition in particular, also fail to specify that the financial institution should be both a knowledgeable and active participant in the residential mortgage market. This is especially important if the financial institution serves as an investment advisor to the plan, and is expected to give sound and timely advice on potential mortgage investments.

MBA's recommended solution to both of these problems is to replace the "established financial institutions" with a new group, which would be broadly classified as "qualified financial institutions" and would be defined as: "any financial or business organization regularly in the business of originating residential mortgage loans."

A second approach to defining "qualified financial institutions" would be to enumerate the major groups of financial institutions and business organizations involved in mortgage origination activities, and also include a general requirement relating to the institutions' mortgage market experience, such as: "any financial institution or business organization regularly in the business of originating residential mortgage loans, and which is also a member of one of the following categories:

A an investment manager described in section 3(38) of ERISA;

B a Federal savings and loan association;

C any lender approved by the Secretary of HUD for participation in any mortgage insurance program under the National Housing Act;

D any state bank as defined in Section 3(a) of the Federal Deposit Insurance Act (12 USC 1813(a));

E any mutual savings bank as defined in Section 3(f) of the Federal Deposit Insurance Act (12 USC 1813(g));

F any savings bank as defined in Section 3(g) of the Federal Deposit Insurance Act (12 USC 1813 (g));

G any building and loan, savings and loan, homestead association, or cooperative bank organized and operated according to the laws of the State, District, Territory or possession in which they are chartered or organized and whose accounts are insured pursuant to Title IV of the National Housing Act (12 USC 1724-1730); and

H any lender approved by FNMA or the FHLMC as a qualified seller/servicer.

Subsection C of Part III defines a residential dwelling unit as "an owner-occupied, detached house, townhouse, condominium, or unit in a multi-unit subdivision (planned unit development)." Considering the excellent investment quality of properly underwritten two- to four-unit residential properties, such properties should be included as allowable investments. The language in the proposed exemption defining residential dwelling units should be replaced with the definition contained in the Department of Labor's class exemption involving mortgage pool investment trusts (part III, subsection E). The definition would real as follows: "'single-family, residential property' means non-farm property comprizing one- to four-dwelling units, and also includes condominiums."

CONCLUSION

Each of these points has been made to the Department of Labor, and we hope it will correct its proposed ruling accordingly. The significance here, however, would not change if the corrections are all made. The defects in the "whole loan" proposal, the omissions in the mortgage-backed security exemption, and the time and the expense incurred to produce each of these inadequate rulings demonstrates the failure of the prohibited transaction exemption mechanism now in ERISA, as interpreted by the Department of Labor, to encourage pension plan investment in the highly sophisticated and rapidly developing housing finance market.

The President's Housing Commission, after reviewing the history of ERISA, observed in its January 6, 1982 preliminary report, "It is not reasonable to prohibit the development of relationships that arise in the normal course of business between the pension plans and such parties as loan originators, sellers, servicers, and mortgagors." MBA therefore applauds efforts to return ERISA to reason.

MBA appreciates the opportunity to appear before the Subcommitte and would be happy to furnish any additional information if needed.

Senator NICKLES. Thank you, Mr. Johnson.

Mr. Doehler?

Mr. DOEHLER. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, I am the staff vice president of the trade association representing the private mortgage insurance industry. I will summarize the major thrust of our testimony.

First, we support the subcommittee's objective to broadly evaluate the widespread legislative and administratively imposed restrictions on pension funds. Second, we recommend that a statutory amendment dealing with mortgage securities be incorporated into the bill the subcommittee has under consideration. Conventional mortgage securities were not in existence when ERISA was enacted.

Because Mr. Groom, an earlier panelist, gave some specific examples of problems of fiduciaries in complying with ERISA and had some charts, I would ask to insert an article written by a Bill Chadwick in the Employee Benefits Journal, published last December. It is an excellent review of some of the parties-in-interest and prohibited transaction problems, specifically related to mortgage pools.

Senator NICKLES. I would be happy to enter it at the conclusion of your statement.

Mr. DOEHLER. Thank you.

The role private mortgage insurers play in housing finance is to provide risk uniformity so that a residential mortgage is a more fungible debt instrument. This role has specific importance to transactions in the secondary mortgage market such as those involving pension funds.

Like other housing interest groups, we support legislative proposals to increase the availability of credit for housing. A stable and adequate flow of funds to housing will aid home affordability and increase the productivity of the construction industry. The stabilization of credit sources to housing must be accomplished with less rather than increased dependence upon governmental intervention.

ERISA reform in S. 1541 can have a direct consequence to housing. Housing financing is undergoing dramatic changes. The thrift industry, for example, has operated as the home lending specialists, but due to an abrupt change in the rules, many thrifts are struggling to stay afloat. Housing can no longer depend upon depository savings as the primary source of capital.

Trends toward retirement savings has changed the financial intermediary role of pension funds and placed vast assets under control of these funds. Pension funds must have full maneuverability. They must be able to pivot and turn in the direction of attractive earning opportunities. Our Nation's productivity and this is all sectors including housing, depends upon all intermediaries and financial markets performing an efficient allocation of savings and investment.

Public Policy should let residential mortgages compete with other investment alternatives for the capital controlled by pension funds. We stress the term "compete" suggesting that pension funds select mortgage investments only because they will be investments with consistent and above average performance. We would limit the focus of regulation to insuring arm's-length relationships and prohibiting unreasonable transactions between parties-in-interest.

The substantial standardization of both the mortgages and mortgage-backed securities brought about by the secondary market agencies GNMA, FHLMC, and the FNMA and defined protections such as truth in lending and RESPA, aid mortgage quality. The home mortgage market has matured and is the Nation's largest and fastest growing debt market. Institutional arrangements have been established with the experience and expertise to help investors participate successfully and profitably in selecting mortgage investments. The level of sophistication of pension managers also suggests ERISA can become a more reasonable law relative to housing investments.

There has been progress by the Department of Labor to deregulate so to permit pension funds more latitude for investment in mortgages, and MICA supports these moves. However, we recommend the subcommittee add to title III an important amendment whose effect would be to permit mortgage-backed securities the same treatment under ERISA now afforded mutual funds of investment companies. Section 3511 of the bill aims to clarify that assets in a collective investment fund of a banking institution are not "plan assets." the language of this section should be broadened; to cover mortgage securities.

The administrative mechanism for granting exemptive relief to classes of fiduciaries or classes of transactions is a slow-moving process. The current law contains too many uncertainties, and it tends to slow innovation and duplicate ERISA protections already available.

A statutory amendment should make clear that a mortgages security representing an interest in a closed pooled investment vehicle constitutes the plan asset and that the mortgage making up the pool do not. Pension plan managers comply with the ERISA protections when considering purchase of a mortgage security and there is no need to have the trustee of the mortgage pool itself duplicate ERISA restrictions already performed by the managers of pension plans. A mortgage pool trustee would be an indirect trustee of the pension plan beneficiaries and should not be required to meet management duties and control functions outside those performed for the benefit of all mortgage certificate holders.

This indirect trustee does not function as an investment intermediary since there is no active reinvestment once a mortgage pool is closed and the certificates are issued. The pool trustee has no delegated investment management authority normally associated with the status of fiduciary under ERISA but simply monitors such things as (1) the accuracy of pool composition, (2) the master servicing of the pool, and (3) the passthrough of monthly principal and interest payments to the investors. Thus naming the underlying mortgages as plan assets subject to ERISA provisions is unnecessary.

The subcommittee also has under consideration the bill S. 1678 that gives specific focus to the prohibited transaction rules of ERISA. Like title III of S. 1541, the objective is to make the ERISA restrictions more reasonable and workable.

S. 1678 would, through statutory amendments, establish certain criteria that if satisfied, would mean that the transaction would not be prohibited by ERISA. While we support this objective we would not want to see the administrative approach used by the Department of Labor for providing exemptive relief become more rigid by establishing specific criteria. For example, the criteria of S. 1678 setting standards for plan trustees to determine whether interest rates on loans for purchase are adequate appear to create complexity rather than simplification.

At this time, we prefer the approach in S. 1541 encouraging the Department of Labor to clearly redefine what is reasonable or adequate consideration in certain prohibited transactions. We would leave the responsibility for such determination with the Department.

With congressional urging, such as your bill, Mr. Chairman, and Senator Hatch and Senator Lugar's bill, we are confident DOL can deregulate and get up to speed with regard to pension fund investment in mortgages. The steps announced by Secretary Donovan were positive. I thought that he indicated in his oral statement that DOL will redefine what constitutes a plan asset. If this is done, it will go a long way toward relieving the problems that mortgage pools have.

We believe the key statutory changes should focus on mortgage-backed securities and adding "reasonableness" to the statute.

Thank you for this opportunity, Mr. Chairman. This association is available to try and provide any additional information the subcommittee may need.

[The prepared statement of Mr. Doehler and the article referred to by him follow:]

STATEMENT OF STEVEN P. DOEHLER REPRESENTING THE MORTGAGE INSURANCE COMPANIES OF AMERICA * ON S.1541, THE RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE SIMPLIFICATION ACT OF L98L. BEFORE THE LABOR SUBCOMMITTEE OF THE SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES.

January 26, 1982

Mr. Chairman and Members of the Subcommittee:

The Mortgage Insurance Companies of America (MICA) appreciates the opportunity to testify on Title III Subtitle E of S.1541 dealing with fiduciary responsibility provisions. Our purpose is to support changes which will permit pension fund managers improved opportunities to invest in residential mortgages especially through certificates representing a security backed by mortgage pools. A qualifying residential mortgage can offer an excellent investment choice which can be made in a manner protective of the rights of plan participants and beneficiaries.

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* The Mortgage Insurance Companies of America is a trade association consisting of thirteen domestic private mortgage insurance companies whose insurance-in-force on November 30, 1981, was $114 billion. The national officers of the Association are Robert L. Waldo (President, Verex Assurance, Inc.), Madison, Wisconsin, President; Leon T. Kendall (President, Mortgage Guaranty Insurance Corporation), Milwaukee, Wisconsin, Vice-President; William A. Simpson (President, Republic Mortgage Insurance Company), Winston-Salem, North Carolina, Secretary; Claude E. Pope (President, American Mortgage Insurance Company), Raleigh, North Carolina, Treasurer; and John C. Williamson, Washington, DC, Executive Vice President.

MICA represents companies that provide mortgage guaranty insurance on residential 1-4 family residences. Private mortgage insurance is used by a lender soley to protect against loss of all or a portion of the principal amount of a mortgage loan upon the default of the mortgagor. It is typically sought by lenders where homebuyers request low downpayment high ratio financing. The reduced borrowers equity in a higher ratio loan directly increases the risk of default and mortgage insurance is used as an offset for risk. Mortgage insurance is especially important for loan originators in that it facilitates sales of mortgages in the secondary market. The underwriting completed prior to issuance of insurance on a loan and the level of protection helps provide risk uniformity and adds fungibility to a mortgage as an investment. In addition to primary coverage on high ratio loans, mortgage insurers provide coverage on pools of a wide range of loan types. Secondary market purchases are the principal method for pension funds to invest in residential mortgages.

Excluding "creative" financing transactions, today a greater percentage than ever of conventional loans being originated involve low homebuyer downpayments and mortgage insurance. High ratio financing helps many families with the problems of affordability. However, downpayment is only one element in affording a home and an equally important element is the cost of the financing. In this regard, the only long run solution for affordable home financing is an adequate and stable supply of housing credit. Since pension funds will represent a growing source of investment capital during this decade public policy should evaluate the social and economic benefits of letting residential mortgages compete with other investment alternatives for capital controlled by the pension funds. We stress the term "compete" suggesting that pension funds select mortgages only because of their superior performance in achieving pension fund investment objectives.

We are confident that the Subcommittee is aware of the many benefits from increased investments in housing. Like other housing interest groups, we have both a social and a direct business interest in supporting legislation and other proposals which can increase the availability of housing credit. However, based on the performance of investments in housing we believe there is no need to have any public policy that would require pension funds to invest in residential mortgages. We feel that if amendment is made to ERISA to give pension fund managers a clear understanding of their ability to make mortgage related investments, the marketplace and those institutions whose business is mortgage sales will adequately educate pension funds as to how to select mortgage investments which will improve the investment goals of their plans.

Any doubts as to the wisdom of permitting pension funds to invest in mortgages should be resolved. The quality of the mortgage as an investment has been demonstrated again and again. Even with all the problems we have in todays housing market, higher default and delinquincy rates are being controlled and mortgage obligations are an excellent investment when compared with investments in the obligations of some of the cities and some of the corporations currently held in the portfolios of many ERISA covered pension plans.

In addition there is rapidly developing improved standardization of mortgage types despite the continuing introduction of various mortgage instrument design features such as adjustable loan rates. The quasi-governmental secondary market agencies, the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) have the ability from their tremendous market power to demand standardization from loan originators. Standardization of both mortgages and conventional mortgage backed securities will help widen the acceptance by an array of capital market investors including the pension funds. This will be especially beneficial as the volume of Ginnie-Maes (pass-through securities of FHA and VA loans backed 100% by the government) shrink as the upstream or middle income homebuyers rely less and less upon government support to enter the housing market.

The problem today, that we hope S.1541 will help to address, is not the ability of mortgage investments to serve the prudent investment needs of pension plans covered by ERISA; the investment performance of mortgages has been documented and education can be done by mortgage insurers, investment bankers and others in the marketplace. Rather, the need is to simply streamline ERISA and its resulting bureaucracy that brings confusion, delay and complexity to those responsible plan managers who wish to at least be able to evaluate the benefits of mortgage related investments for their portfolios. Title III aims to provide corrections, clarifications and simplifications in ERISA to make the act a more reasonable law while protecting worker's pension rights. Such correction is needed.

When ERISA was enacted, Congress delegated broad exemptive powers to the Department of Labor in order to avoid customary business transactions from being needlessly prohibited. In recent years and months, DOL has been taking steps and announcing plans to deregulate in some areas so to permit pension plans more latitude to invest in real estate and mortgage securities. These actions are to be commended. A liberalization of the prudent man rule so that investments made by pension funds can be judged more in accordance with modern portfolio theory, looking at whole portfolios rather than individual investments, is appropriate. Fund managers should be able to select investments with different levels of risk yet be acting in an entirely prudent manner. Permitting investments by pension funds in small business, for example, even though potentially of higher risk, have been viewed by DOL as prudent and can serve the plans investment needs. We support this liberalization and other liberalizations that are contained in the Subcommittee bill. Looking at the size of the assets in many pension trusts there is now a much higher level of sophistication and professionalism among the investment advisors being employed by these trusts.

Within this move to make ERISA more reasonable, investment in mortgages should be looked upon more realistically giving fund managers more latitude on the types of whole loans and mortgage securities they wish to purchase. In the final analysis, we not only support broad latitude for investment in mortgages but argue against any need for guidelines to define characteristics of mortgage loans packaged as securities which would be acceptable for pension fund investment. This can be accomplished by the marketplace. We do favor administrative exemptions for plan purchases of individual mortgages.

Today's mortgage market can involve loans with a wide range of characteristics and investors make market judgements on the acceptability of various loan characteristics. Diversity should be allowed in a competitive marketplace. Fund managers who do not feel direct investment for the pension trusts in whole loans are acceptable can make mortgage related investments in mortgage pass-through securities that have received ratings (or meet explicit guidelines) established either by the pension trusts themselves or by Standard & Poors Corporation and other similar rating agencies. We would recommend that the major regulatory concern need only to focus upon making sure all transactions involve an "arms length" relationship by the fund including removing other conflicts of interests on the part of the fund managers where less than a fair market price for an investment or a service for an investment is paid. This can be done through investigations and lawsuits by the regulators rather than by complex rules.

The Subcommittee bill S.1541 is aimed in this direction and this is justified because the mortgage marketplace has changed significantly in recent years. Pension fund managers are far less able to make "sweetheart" mortgage loans to potential parties in interest now that there is more uniform a national housing finance marketplace characterized by consumer protections such as truth in lending and other disclosure requirements. Mortgage finance is more an "arms length" transaction than probably any other similar debt transaction. The need for liquidity by originators and the organized secondary market guidelines assures this is the case.

When ERISA was enacted apparently there was substantial concern that it would be very difficult to police dealings between pension funds and related parties and abuses would arise. The rules involving so called parties in interest which attempt to provide an administrative procedure for obtaining relief for "non-abuse" transactions are now clearly too complex based upon traditional functioning of the mortgage market. In taking pains to avoid violating ERISA, many pension managers have seen too many potential problems related to mortgage investment.

In order to remedy the understandable reluctance of pension fund managers to consider mortgage related investments, DOL has administratively considered redefining certain mortgage assets such as the assets of mortgage pool investment trusts to be classified as not constituting "plan assets". Such classification means the pool sponsors and the trustee of the pool will not be viewed as parties in interest with the responsibilities that fiduciaries or service providers have to the plan under ERISA. DOL has also focused upon the prohibited transaction exemptions contained in Sections 406 through 408 of ERISA and last January DOL provided exemptive relief for certain class of transactions by pension funds involving mortgage pools modeled after the pass-through securities of GNMA and FHLMC. While administrative approaches to clarifying ERISA problems can go a long way in correcting uncertainties involving pension fund investment in mortgage related investment, we believe that there would be substantial benefit in having a statutory exemption to more broadly and immediately address uncertanities involving investment by pension funds in mortgage securities.

We would hope the Subcommittee would address in its legislation the question as to whether a mortgage security respresenting an interest in a pooled investment vehicle constitutes the plan asset rather than the underlying property namely the mortgages making up the pool. It is MICA's view that because of the stage of development and the structure of mortgage-backed securities, the Subcommittee could adopt language which would make clear that the certificates representing mortgage-backed securities purchased by employee plans would be regarded as plan assets and that interests in mortgage underlying such certificates would not be so regarded. In other words the treatment of mortgage securities backed by mortgage pools would parallel that for investment company mutual funds. Although this has been under consideration by the DOL for administrative action, the advantage of Subcommittee endorsement is clear.

An example problem of treating mortgages underlying mortgage-backed securities as assets of the plans investing in such securities is that these mortgages must not only be held in trust but the trustee holding such mortgages has to be named in the plan trust instrument (or plan document) or appointed by the fiduciary of the investing plan. Further this trustee holding the mortgages must meet certain requirements regarding his ability to manage and control those mortgages. These requirements found in various sections of ERISA cannot practically be met. It is not realistic to expect an employee plan contemplating investment in a mortgage security to amend the plan document to name in that document the pool trustee of the proposed mortgage investment. Likewise, the management and control function demanded of the trustee, such as for the servicing of the mortgage payments, is to be the responsibility of the pool sponsor. It would not be workable to have the plan trustee provide such management.

We would suggest the Subcommittee evaluate the circumstances involved in structuring and issuing a mortgage-backed security and determine whether the protections of the fiduciary responsibilities provisions of ERISA are unnecessary. It appears that administrative determinations by DOL have been based on the rationale that ERISA protections applicable where a plan retains a manager of its investments directly should also be applicable where the manager is retained indirectly through investment by the plan in a pool investment vehicle. Congress can of course exempt a specific investment vehicle or there can be an administratively provided class exemption.

This rationale for applying the fiduciary protections of ERISA ultimately rests on whether there is any delegation of investment management authority to the indirect manager of the pooled assets. If the indirect manager does not function as an investment intermediary, and this is the case in mortgage-backed securities since there is no active reinvestment once the mortgage pool is closed and the certificates have been issued, then there is no delegation of investment management authority. The investing plan holding the certificate cannot be regarded as indirectly delegating any of the investment discretion normally associated with the status of fiduciary. The protections of ERISA would persist with regard to the actions of the direct manager of the pension plan itself for the protection of plan beneficiaries, thus there is no need for the indirect manager whose duties do not involve investment to be subject to such protections. The Subcommittee should conclude that interests in the mortgages underlying the certificates of the mortgage security need not be regarded as plan assets.

Therefore, the major justification for making the change which would redefine "plan assets" in such a way that the management activities of the sponsor of a mortgage-backed security would no longer be subject to the provisions of ERISA, comes from the structure of the mortgage participation securities or certificates. Because there is no investment management activity there is no justification for treating pass-throughs as anything other than a security for ERISA purposes.

Pass-through securities are structured to mirror a mortgage passing through the borrowers principal and interest monthly to the investor. * The security represents a beneficial interest in a specified pool of mortgages. GNMA developed the basic pass-through model in 1970. A trustee-custodian is established to provide protection against fraud, procedural deficiencies and to insure that the issuer of the security fulfills such responsibilities as advancing deliquent mortgage payment and other management functions defined for the issuer in the documents.

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* The dollar balance of the mortgages or mortgage participations in a specific pool is identical to the balance of the pass-through instrument. Payments of principal, interest and prepayments of the mortgage pays down the balance in the mortgage pool follows the same schedule as the payments made (or passed through) to the certificate holder.

To date, the rating agencies, primarily Standard and Poors, have played an important role in establishing market guidelines for pass-through securities. For example the involvement of insurance in the structure of the securities has been specified by these evaluators to require: (a) individual mortgages must carry the usual homeowner's policy against standard hazards plus a standard hazard policy in an amount equal to 1% of the pool balance to cover risks not covered by the individual homeowners policies; (b) a pool insurance policy or credit reserve be established to provide coverage against default equal to about 5% of the initial pool balance; (c) mortgages in excess of 80% loan to value must carry individual mortgage insurance policies; (d) insurance against failure by the sponsors or any other entity providing services. Such guides have helped bring uniformity to the market and simplify the purchase decision by investors such as pension plan managers. Many pass-throughs, but especially those with a rating assigned to the issue by a rating agency and those having undergone independent review by the mortgage insurer being a party at risk, have a high degree of uniformity and can be characterized by their fungible nature. The basic investment rules such as diversification and spread of risk plus the level of protection has typically allowed the securities to trade at yeilds equivalent to "AA" corporate bonds and achieve an increasing degree of liquidity. The market has progressed in defining investment quality.

Another major justification, permitting pension funds greater flexibility to choose mortgage related investments, is economic and in the interest of pension beneficiaries. Today the mortgage finance market has been restructured. Institutions are changing their traditional roles and there is less support by the federal government. Regulation Q for example had until recently extablished a "support" price for mortgages by artifically keeping the cost of funds low for those depository institutions making mortgage loans. Borrowers paid less for their home loans and investors in mortgages have obtained lower yields. To a large extent, this has kept pension fund interest in mortgages to a minimum. Today, as the mortgage bankers can attest, housing funds must be attracted at market rates and homebuyers must pay market rates. While higher financing costs hurt the homebuyer and the business interests of the housing industry, the results have brought a significant increase in yields available to investors in mortgages. Mortgage yields have been better than corporate bonds during periods in the past but this will probably mean a stabilized higher differential in the future. The $200 billion or so debt created by mortgages compared to about $35 billion of corporate and $45 billion of municipal debt can offer many very attractive investments for pension funds.

To conclude my testimony and illustrate the changes taking place in the mortgage market, I have exerpted some charts used by MICA Vice President, Leon Kendall, in a recent appearance before the House Subcommittee on Community Development.

Chart I converts population in the 25-34 age bracket into housing starts and multiplies this by the historic percentage of those in this high homebuying period to obtain a theoretic level of new housing units necessary to meet the projected demand. This is a clear measure of need.

Chart II is based upon data published by Regional Data Associates and projects demand for mortgage funds through 1989 to be in excess of $1 trillion. The supply estimates using the traditional sources, including saving and loans, savings banks, mortgage bankers and commercial banks illustrate a significant shortfall. This shortfall suggests higher cost of mortgage funds to reduce demand or attract significant new sources such as from pension funds. The size of this shortfall indicates there will be strong market forces available to help keep yields high and thus help bid up yields for the pension fund investment.

Chart III reviews who supplies mortgage funds. Perhaps the key point is to note the growth of pools as an acquirer of mortgage debt. Pools will continue to rise but at a substantially increased rate if pension funds have more latitude for such investments.

Chart IV presents secondary market purchases in 1980 and there is a dominance by Ginnie Mae pools. As less dependence upon government guarantees is effected there should be a major shift toward conventional pools replacing the GNMA security purchases.

Chart V of Merril Lynch Economics has estimated major shifts in the composition of those who buy mortgages. Improved pension fund participation was anticipated but this estimate is low if more latitude in mortgage investment options is given ERISA funds.

Chart VI documents that home mortgage rates have yielded about a 2% differential over and above AAA corporate bonds prior to Regulation Q. When Regulation Q and Ginnie Mae guarantees predominated this spread narrowed but with the atrophying of Regulation Q the spread has started to widen again. As conventional pass-throughs replace Ginnie Mae the 2% or better differential will probably stabilize for the remainder of the decade.

In summing up, this Subcommittee should take immediate steps to remove the ERISA impediments as they apply to investment in mortgage securities. Pension managers, now more highly sophisticated in terms of the investment management skills, should have no questions as to their ability to choose mortgages from among other investment alternatives. . In addition, we urge the Subcommittee to broadly draft an amendment to parallel the treatment of other pooled investments such as mutual funds so that their maximum degree of innovation can take place in this market for mortgage securities..

Pension funds can help deliver substantial amounts of capital to every community in our nation. The mortgage is the backbone of our debt structure and homeownership is an essential national goal. The individual savings of pension fund beneficiaries can be invested in a sound profitable manner in mortgages and bring substantial benefits to our country.

We appreciate this opportunity to present our views and would be happy to supply any additional information the Subcommittee would deem helpful.

CHART I

Housing Starts Needed For Supply/Demand Equilibrium

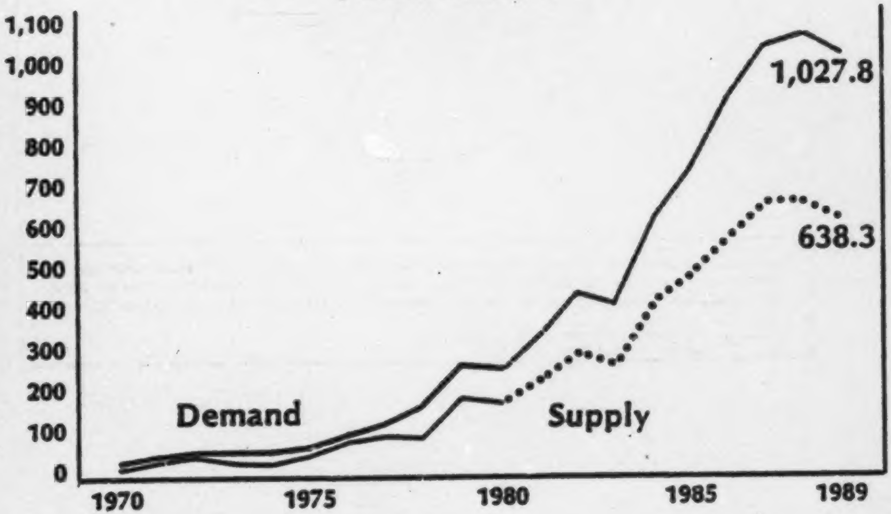
Year	Projected 25-34 Year Old Population (In Thousands)	Historical Ratio of 25-34 Year Olds to Housing Starts*	Equilibrium Housing Starts (In Thousands)
1980	33,026	16.53	1,997.9
1985	39,713	16.53	2,402.5
1990	40,940	16.53	2,476.7

Sources: Regional Data Associates, MGIC
*(1959 - 1977)

CHART II

Availability of Mortgage Funds

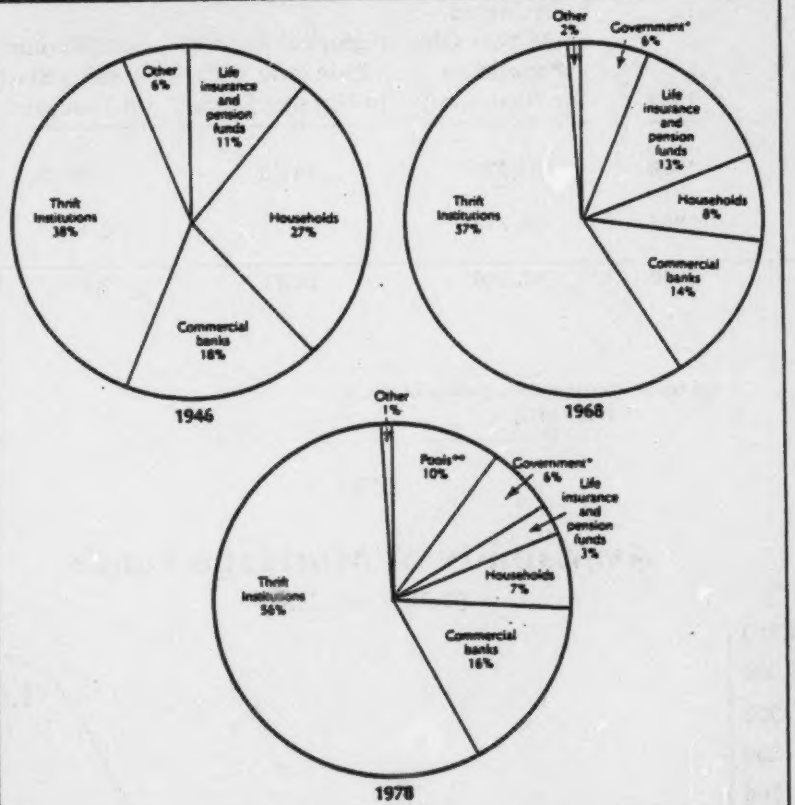
(Dollars in Billions)



Source: RDA

CHART III

Holders of Home Mortgages



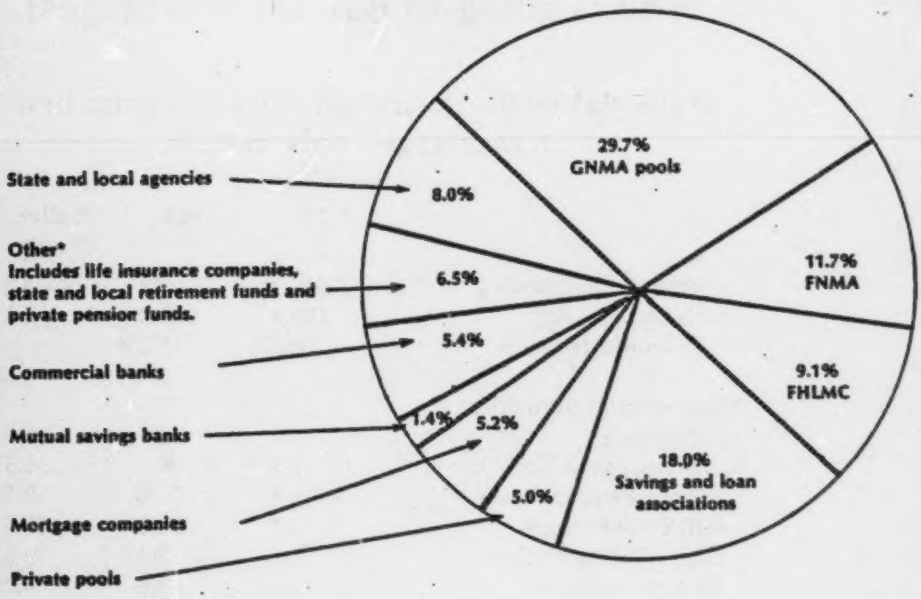
* Federal, state and local, including directly held mortgages and holdings of sponsored credit agencies.
** Pass-through securities backed by these pools are ultimately held by a variety of investor groups, including those listed here but are carried on the books separately from direct-mortgage holdings.

Source: Board of Governors of the Federal Reserve System Flow of Funds

CHART IV

1980 Secondary Market Purchases of 1 - 4 Family Mortgage Loans

Total: $69.3 billion



Source: HUD

CHART V

Who is going to buy the mortgages?

Potential Institutional/Individual Participation in Mortgage Pools to 1985

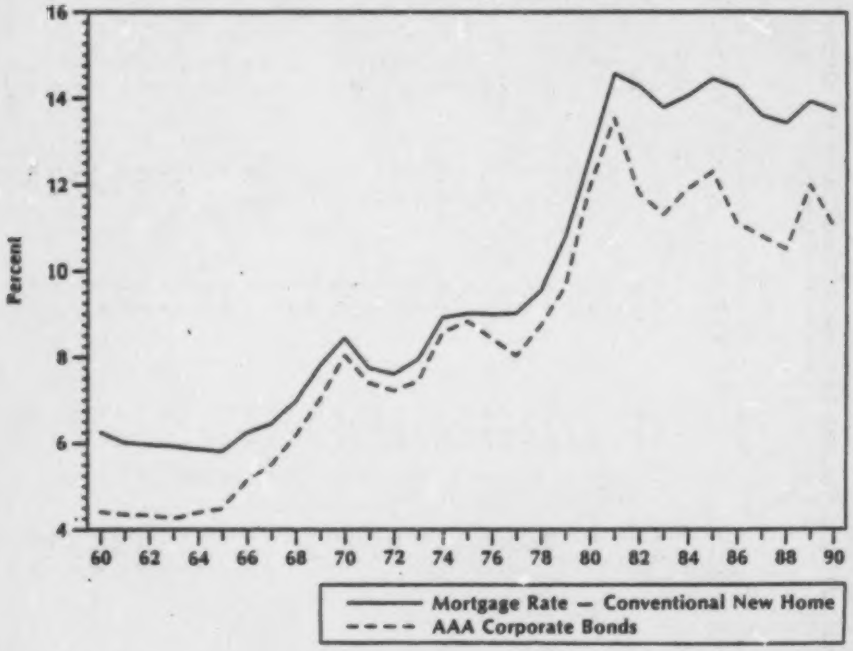
(Billions of $)

	1979	1985	Dollar Change
Mortgages Outstanding	1004.2	2009.1	1004.9
Pools Outstanding	108.4	387.8	279.3
Pools as Mortgage %	10.8%	19.3%	
Ownership of Securities			
Individuals	8.5	35.0	26.5
Life Insurance Cos.	3.5	40.0	36.5
Private Pension Funds	3.5	20.0	19.0
Retirement Funds	9.0	30.5	21.5
Other Insurance Cos.	1.0	7.0	4.0
Foreign Investors		4.0	4.0

Source: Merrill Lynch Economics Inc.

CHART VI

Mortgage Rates vs. Corporate Bond Yields



STATE AND LOCAL GOVERNMENT RETIREMENT FUNDS ASSETS AND LIABILITIES, 1949-1980
(Percent Distribution)

	Total Financial Assets	Demand Deposits & Currency	Corporate Equities	Credit Market Instruments	U.S. Government Securities	Treasury Issues	Agency Issues	State and Local Obligations	Corporate Bonds	Mortgages
1949	100.0%	2.4%	0.5%	97.1%	54.0%	54.0%	0.0%	32.3%	9.6%	1.2%
1950	100.0	2.5	0.6	97.0	51.5	51.5	0.0	31.9	12.0	1.5
1951	100.0	2.5	0.7	96.8	52.0	52.0	0.0	30.5	12.5	1.9
1952	100.0	2.4	0.8	96.8	51.1	50.8	0.3	28.3	15.2	2.1
1953	100.0	2.4	0.9	95.7	48.8	48.5	0.3	26.4	19.2	2.4
1954	100.0	2.1	1.0	96.9	46.8	46.4	0.4	25.1	22.4	2.6
1955	100.0	1.6	1.8	96.5	43.6	43.1	0.5	25.1	24.9	2.9
1956	100.0	1.6	1.7	96.8	41.5	41.0	0.6	25.8	26.2	3.3
1957	100.0	1.7	2.2	96.1	37.4	36.7	0.7	25.7	29.2	3.9
1958	100.0	1.6	2.6	95.9	32.9	32.2	0.7	25.4	32.8	4.7
1959	100.0	1.3	2.8	95.9	31.9	31.1	0.8	24.2	34.1	5.6
1960	100.0	1.2	3.0	95.7	29.9	28.9	1.0	22.3	36.1	7.3
1961	100.0	1.2	4.0	94.7	27.3	26.1	1.2	19.2	39.8	8.5
1962	100.0	1.3	4.1	94.7	26.5	24.9	1.6	15.5	43.5	9.1
1963	100.0	1.1	5.5	93.4	25.1	23.8	1.3	12.1	46.7	9.5
1964	100.0	1.0	6.5	92.5	24.2	22.9	1.2	9.5	48.8	10.0
1965	100.0	0.9	7.3	91.7	22.4	21.0	1.4	7.7	50.6	11.0
1966	100.0	1.0	7.3	91.7	20.4	18.7	1.7	6.5	53.0	11.8
1967	100.0	1.1	9.1	89.8	16.3	14.5	1.8	5.6	56.1	11.7
1968	100.0	1.3	12.1	86.7	15.3	12.3	2.9	5.0	55.3	11.2
1969	100.0	0.9	13.7	85.4	13.2	10.2	2.9	4.4	57.4	10.5
1970	100.0	1.0	16.7	82.3	10.9	8.5	2.5	3.4	58.1	9.8
1971	100.0	1.0	22.3	76.7	7.9	5.6	2.2	3.1	56.5	9.1
1972	100.0	1.2	27.5	71.3	7.1	4.5	2.6	2.5	53.6	8.0
1973	100.0	1.6	23.9	74.6	6.9	3.0	3.9	2.0	57.2	8.4
1974	100.0	2.0	18.6	79.3	7.0	1.8	5.2	1.1	62.4	8.8
1975	100.0	1.4	23.2	75.4	7.4	2.4	5.0	1.9	58.9	7.2
1976	100.0	1.2	25.0	73.9	9.0	3.4	5.7	2.8	55.6	6.4
1977	100.0	1.3	22.6	76.1	12.4	5.0	7.4	2.7	54.8	6.2
1978	100.0	1.8	21.8	76.4	14.9	6.8	8.1	2.6	53.2	5.7
1979	100.0	2.4	21.8	75.8	17.5	7.9	9.6	2.3	50.6	5.5
1980	100.0	2.0	26.7	71.3	19.5	8.6	10.9	2.0	44.9	4.9

Source: Federal Reserve Board

STATE AND LOCAL GOVERNMENT RETIREMENT FUNDS ASSETS AND LIABILITIES, 1949-1980
(in billions of dollars)

	Total Financial Assets	Demand Deposits & Currency	Corporate Equities	Credit Market Instruments	U.S. Government Securities	Treasury Issues	Agency Issues	State and Local Obligations	Corporate Bonds	Mortgages
1949	$ 4.2	$0.1	$ 0.0	$ 4.1	$ 2.3	$ 2.3	$ 0.0	$1.3	$ 0.4	$0.1
1950	4.9	0.1	0.0	4.7	2.5	2.5	0.0	1.5	0.6	0.1
1951	5.6	0.1	0.0	5.4	2.9	2.9	0.0	1.7	0.7	0.1
1952	6.6	0.2	0.1	6.4	3.4	3.4	0.0	1.9	1.0	0.1
1953	8.0	0.2	0.1	7.7	3.9	3.9	0.0	2.1	1.5	0.2
1954	9.5	0.2	0.1	9.2	4.4	4.4	0.0	2.4	2.1	0.2
1955	10.8	0.2	0.2	10.5	4.7	4.7	0.1	2.7	2.7	0.3
1956	12.1	0.2	0.2	11.7	5.0	4.9	0.1	3.1	3.2	0.4
1957	13.8	0.2	0.3	13.3	5.2	5.1	0.1	3.5	4.0	0.5
1958	15.6	0.2	0.4	15.0	5.1	5.0	0.1	4.0	5.1	0.7
1959	17.6	0.2	0.5	16.8	5.6	5.5	0.1	4.3	6.0	1.0
1960	19.7	0.2	0.6	18.9	5.9	5.7	0.2	4.4	7.1	1.5
1961	22.3	0.3	0.9	21.1	6.1	5.8	0.3	4.3	8.9	1.9
1962	24.5	0.3	1.0	23.2	6.5	6.1	0.4	3.8	10.7	2.2
1963	27.4	0.3	1.5	25.6	6.9	6.5	0.3	3.3	12.8	2.6
1964	30.6	0.3	2.0	28.3	7.4	7.0	0.4	2.9	14.9	3.1
1965	34.1	0.3	2.5	31.3	7.6	7.2	0.5	2.6	17.2	3.7
1966	38.1	0.4	2.8	34.9	7.8	7.1	0.7	2.5	20.2	4.5
1967	42.6	0.5	3.9	38.3	7.0	6.2	0.8	2.4	23.9	5.0
1968	48.0	0.6	5.8	41.6	7.3	5.9	1.4	2.4	26.6	5.4
1969	53.2	0.5	7.3	45.5	7.0	5.4	1.6	2.3	30.6	5.6
1970	60.3	0.6	10.1	49.6	6.6	5.1	1.5	2.0	35.1	5.9
1971	69.0	0.7	15.4	52.9	5.4	3.9	1.5	2.2	39.0	6.3
1972	80.6	1.0	22.2	57.4	5.7	3.6	2.1	2.0	43.2	6.5
1973	84.7	1.3	20.2	63.1	5.8	2.5	3.3	1.7	48.4	7.1
1974	88.0	1.8	16.4	69.8	6.2	1.6	4.6	1.0	54.9	7.7
1975	104.8	1.4	24.3	79.1	7.8	2.5	5.3	1.9	61.8	7.5
1976	120.6	1.4	30.1	89.1	10.9	4.1	6.8	3.4	67.1	7.7
1977	132.6	1.7	30.0	100.9	16.5	6.6	9.8	3.5	72.7	8.2
1978	153.0	2.8	33.3	116.9	22.8	10.5	12.4	4.0	81.4	8.7
1979	170.1	4.0	37.1	129.0	29.7	13.5	16.3	3.9	86.0	9.4
1980	202.7	4.1	54.2	144.5	39.5	17.5	22.0	4.0	91.1	9.9

Source: Federal Reserve Board

PRIVATE PENSION FUNDS ANNUAL FLOWS, 1949-1980
(in millions of dollars)

	Net Acquisition of Financial Assets	Demand Deposits & Currency	Time Deposits	Corporate Equities	Credit Market Instruments	U.S. Government Issues	Corporate Bonds	Mortgages	Miscellaneous Assets
1949	$ 636	$ 43	$ 0	$ 124	$ 589	$ 250	$ 319	$ 20	$-120
1950	1,694	60	0	519	1,085	100	965	20	30
1951	1,121	65	0	253	773	100	655	18	30
1952	1,658	-19	0	478	1,127	33	1,065	29	72
1953	1,901	56	0	545	1,319	177	1,099	43	-19
1954	2,041	-9	0	709	1,333	27	1,260	46	8
1955	2,309	58	0	739	1,339	310	946	83	173
1956	2,727	0	0	941	1,557	-193	1,622	128	229
1957	3,040	51	0	1,135	1,772	-224	1,862	134	82
1958	3,101	30	0	1,381	1,656	-8	1,505	159	34
1959	3,663	39	0	1,743	1,734	244	1,243	247	147
1960	3,961	11	0	1,946	1,798	-128	1,614	312	206
1961	3,939	114	0	2,258	1,474	32	1,183	259	93
1962	4,181	47	0	2,198	1,745	210	1,219	316	191
1963	4,253	66	0	2,170	1,927	124	1,459	344	90
1964	5,468	119	0	2,212	2,348	144	1,646	558	789
1965	5,411	49	0	3,124	1,905	-199	1,497	607	333
1966	6,899	-183	142	3,479	2,811	-243	2,528	526	650
1967	6,562	136	283	4,562	869	-427	1,124	172	712
1968	6,509	121	152	4,822	1,061	432	645	-16	353
1969	6,342	9	18	5,382	798	36	613	149	135
1970	6,913	82	103	4,566	2,022	237	1,830	-45	140
1971	7,079	199	-362	8,915	-1,639	-297	-829	-513	-34
1972	6,652	262	-46	7,285	-993	957	-1,020	-930	157
1973	8,265	-215	794	5,290	2,250	715	1,887	-352	146
1974	10,702	-15	2,665	2,305	5,613	1,129	4,488	-4	134
1975	11,814	115	-1,339	5,772	7,023	5,231	1,781	11	243
1976	11,234	123	-78	7,302	3,647	3,949	-289	-13	240
1977	17,682	95	2,474	4,460	11,159	5,425	5,369	365	-506
1978	19,629	92	5,497	5,332	8,582	2,105	5,904	573	126
1979	21,100	100	-1,400	13,100	8,900	2,800	5,700	500	400
1980	22,300	100	1,400	9,600	10,800	5,800	4,400	600	400

Source: Federal Reserve Board

PRIVATE PENSION FUND ASSETS AND LIABILITIES, 1949-1980
(Percent Distribution)

	Total Financial Assets	Demand Deposits & Currency	Time Deposits	Corporate Equities	Credit Market Instruments	Treasury Issues	Agency Issues	Corporate Bonds	Mortgages	Miscellaneous Assets
1949	100.0%	3.8%	0.0%	10.9%	78.1%	41.9%	0.0%	34.7%	1.5%	7.1%
1950	100.0	3.7	0.0	15.7	74.8	33.2	0.0	40.1	1.4	5.8
1951	100.0	4.0	0.0	16.6	74.0	29.9	0.0	42.6	1.5	5.4
1952	100.0	3.1	0.0	18.7	72.9	25.2	0.0	46.2	1.5	5.2
1953	100.0	3.1	0.0	20.4	72.3	22.4	0.2	48.1	1.6	4.2
1954	100.0	2.6	0.0	22.8	71.0	19.3	0.1	49.9	1.7	3.6
1955	100.0	2.3	0.0	33.2	60.9	16.2	0.1	42.8	1.8	3.7
1956	100.0	2.0	0.0	33.5	60.3	13.0	0.2	44.9	2.1	4.3
1957	100.0	2.0	0.0	32.0	61.8	10.5	0.5	48.4	2.5	4.2
1958	100.0	1.7	0.0	39.6	55.3	8.4	0.4	43.9	2.5	3.5
1959	100.0	1.6	0.0	42.6	52.4	7.7	0.6	41.3	2.9	3.4
1960	100.0	1.4	0.0	43.4	51.6	6.3	0.7	41.2	3.4	3.6
1961	100.0	1.4	0.0	49.5	45.9	5.3	0.6	36.6	3.4	3.2
1962	100.0	1.5	0.0	46.4	48.6	5.5	0.7	38.4	4.0	3.5
1963	100.0	1.4	0.0	50.3	45.1	4.9	0.7	35.6	4.0	3.2
1964	100.0	1.4	0.0	52.4	42.3	4.2	0.7	33.0	4.3	3.9
1965	100.0	1.3	0.0	55.3	39.5	3.4	0.6	30.8	4.6	3.9
1966	100.0	1.0	0.2	52.1	42.1	3.0	0.6	33.3	5.2	4.6
1967	100.0	1.0	0.5	57.2	36.6	2.2	0.4	29.5	4.6	4.7
1968	100.0	1.0	0.6	60.6	33.3	2.3	0.4	26.6	4.0	4.5
1969	100.0	1.0	0.6	60.0	33.8	2.1	0.6	27.0	4.1	4.6
1970	100.0	1.0	0.6	60.8	33.2	1.9	0.8	26.7	3.8	4.4
1971	100.0	1.0	0.3	68.1	26.9	1.6	0.5	22.0	2.8	3.7
1972	100.0	1.0	0.2	73.8	21.8	1.9	0.5	17.7	1.7	3.2
1973	100.0	1.0	0.8	67.4	27.0	2.3	0.9	21.9	1.8	3.8
1974	100.0	1.2	3.2	54.8	36.3	2.6	2.2	29.4	2.1	4.6
1975	100.0	1.0	1.6	60.3	33.3	5.1	2.3	24.3	1.6	3.8
1976	100.0	0.9	1.4	63.8	30.6	6.5	2.1	20.6	1.4	3.3
1977	100.0	0.9	2.7	57.1	36.4	8.9	2.4	23.6	1.5	2.9
1978	100.0	0.9	5.2	54.3	36.9	8.8	2.4	24.2	1.5	2.7
1979	100.0	0.9	4.0	55.6	37.0	8.7	2.5	24.1	1.6	2.6
1980	100.0	0.7	3.9	59.8	33.4	8.2	2.8	21.0	1.4	2.2

Source: Federeal Reserve Board

PRIVATE PENSION FUND ASSETS AND LIABILITIES, 1949-1980
(in billions of dollars)

	Total Financial Assets	Demand Deposits & Currency	Time Deposits	Corporate Equities	Credit Market Instruments	Treasury Issues	Agency Issues	Corporate Bonds	Mortgages	Miscellaneous Assets
1949	$ 5.4	$0.2	$ 0.0	$ 0.6	$ 4.2	$ 2.2	$0.0	$ 1.9	$0.1	$0.4
1950	7.1	0.3	0.0	1.1	5.3	2.3	0.0	2.8	0.1	0.4
1951	8.2	0.3	0.0	1.4	6.0	2.4	0.0	3.5	0.1	0.4
1952	9.8	0.3	0.0	1.8	7.2	2.5	0.0	4.5	0.1	0.5
1953	11.7	0.4	0.0	2.4	8.5	2.6	0.0	5.6	0.2	0.5
1954	13.8	0.4	0.0	3.2	9.8	2.7	0.0	6.9	0.2	0.5
1955	18.3	0.4	0.0	6.1	11.2	3.0	0.0	7.9	0.3	0.7
1956	21.1	0.4	0.0	7.1	12.7	2.8	0.0	9.5	0.4	0.9
1957	23.4	0.5	0.0	7.5	14.5	2.5	0.1	11.3	0.6	1.0
1958	29.2	0.5	0.0	11.6	16.2	2.5	0.1	12.8	0.7	1.0
1959	34.1	0.5	0.0	14.5	17.9	2.6	0.2	14.1	1.0	1.2
1960	38.1	0.5	0.0	16.5	19.7	2.4	0.3	15.7	1.3	1.4
1961	46.1	0.7	0.0	22.9	21.2	2.4	0.3	16.9	1.6	1.5
1962	47.2	0.7	0.0	21.9	22.9	2.6	0.3	18.1	1.9	1.7
1963	55.0	0.8	0.0	27.7	24.8	2.7	0.4	19.6	2.2	1.7
1964	64.3	0.9	0.0	33.7	27.2	2.7	0.5	21.2	2.8	2.5
1965	73.6	0.9	0.0	40.8	29.1	2.5	0.5	22.7	3.4	2.9
1966	75.8	0.8	0.1	39.5	31.9	2.3	0.4	25.2	3.9	3.5
1967	89.4	0.9	0.4	51.1	32.8	2.0	0.3	26.4	4.1	4.2
1968	101.5	1.0	0.6	61.5	33.8	2.4	0.4	27.0	4.1	4.6
1969	102.4	1.0	0.6	61.4	34.6	2.2	0.6	27.6	4.2	4.7
1970	110.4	1.1	0.7	67.1	36.6	2.1	0.9	29.4	4.2	4.9
1971	130.1	1.3	0.3	88.7	35.0	2.1	0.6	28.6	3.7	4.8
1972	156.1	1.6	0.3	115.2	34.0	3.0	0.7	27.6	2.7	5.0
1973	134.3	1.4	1.1	90.5	36.3	3.1	1.3	29.5	2.4	5.1
1974	115.6	1.3	3.7	63.3	41.9	3.0	2.6	34.0	2.4	5.3
1975	146.8	1.5	2.4	88.6	48.9	7.4	3.3	35.8	2.4	5.5
1976	171.9	1.6	2.3	109.7	52.5	11.1	3.6	35.5	2.4	5.7
1977	178.5	1.7	4.8	101.9	65.0	15.9	4.2	42.1	2.7	5.2
1978	198.6	1.8	10.3	107.9	73.3	17.5	4.7	48.0	3.1	5.4
1979	222.4	1.9	8.9	123.7	82.2	19.4	5.6	53.7	3.5	5.8
1980	286.1	1.9	11.3	171.1	95.6	23.5	8.1	60.1	4.0	6.2

Source: Federal Reserve Board

SELECTED INTEREST RATES AND YIELDS, 1970-80

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1970-1980 Aver.	1975-1980 Aver.
6 Month T-Bill, Secondary mkt.	6.51%	4.52%	4.49%	7.20%	7.95%	6.11%	5.26%	5.53%	7.58%	10.06%	11.37%	6.96%	7.65%
12 Month T-Bill, Secondary mkt.	6.49	4.67	4.77	7.01	7.71	6.30	5.52	5.71	7.74	9.75	10.89	6.96	7.65
Moody Aaa	6.12	5.22	5.04	4.99	5.89	6.42	5.66	5.20	5.52	5.92	7.85	5.80	6.10
Moody Baa	6.75	5.89	5.60	5.49	6.53	7.62	7.49	6.12	6.27	6.73	9.01	6.68	7.21
20 Year Treasury Bonds	-	-	-	-	8.05	8.19	7.86	7.67	8.48	9.33	11.39	-	8.82
30 Year Treasury Bonds	-	-	-	-	-	-	-	-	8.49	9.29	11.30	-	-
Dividend/Price Ratio													
Preferred Stocks	7.22	6.75	7.27	7.23	8.21	8.38	7.97	7.60	8.25	9.07	10.57	8.05	8.64
Common Stocks	3.83	3.14	2.84	3.06	4.47	4.31	3.77	4.56	5.28	5.46	5.25	4.18	4.77
FNMA Auctions													
Government Underwritten Loans	9.00	7.82	7.64	8.33	9.31	9.26	8.99	8.73	9.71	11.50	14.15	9.49	10.39
Conventional Loans	-	-	7.82	8.53	9.43	9.37	9.11	9.05	10.01	11.77	14.43	-	10.62
FHLBB Effective Rate													
Newly Built Homes	8.45	7.74	7.60	7.96	8.93	9.02	9.00	9.01	9.54	10.77	12.65	9.15	10.00
Previously Occupied Homes	8.36	7.67	7.51	8.02	9.04	9.21	9.11	9.02	9.58	10.92	12.95	9.22	10.13
All Homes	8.38	7.69	7.53	8.00	9.00	9.16	9.08	9.02	9.56	10.87	12.86	9.20	10.09

Source: Federal Reserve Board. Federal National Mortgage Association. Federal Home Loan Bank Board

MORTGAGES AS AN INVESTMENT

Over the 1970s, home mortgage interest rates have generally been higher than interest rates in the money and capital markets. Between 1970 and 1980, the Federal Home Loan Bank Board's conventional mortgage rates for newly built and previously occupied homes averaged 9.2 percent, and FNMA yields on government underwritten loans were about 9.5 percent. Over the same period, both six-month and twelve-month Treasury Bills in the secondary market yielded slightly less than 7 percent, Moody's Baa bonds yielded about 6.7 percent, and Moody's Aaa bonds yielded 5.8 percent. The dividend/price ratio for preferred stocks was slightly more than 8 percent, while common stocks were at a meager 4.18 percent.

The same basic relationships exist if one examines the 1975-1980 period, except that all the rates are slightly higher. Also, twenty-year Treasury Bonds were between 100 and 200 basis points lower than the mortgage rates in the primary and secondary markets during this period; and in the secondary market, conventional loans had yields 33 basis points higher than government loans at FNMA auctions.

All in all, home mortgage rates compare very favorably to interest rates on various types of investments.

STATE AND LOCAL GOVERNMENT RETIREMENT FUNDS ANNUAL FLOWS, 1949-1980
(in millions of dollars)

	Net Acquisition of Financial Assets	Demand Deposits & Currency	Corporate Equities	Credit Market Instruments	U.S. Government Securities	Treasury Issues	Agency Issues	State and Local Obligations	Corporate Bonds	Mortgages
1949	$ 536	$ 10	$ 7	$ 519	$ 184	$ 184	$ 0	$ 183	$ 135	$ 17
1950	674	18	9	647	241	241	0	200	183	23
1951	760	19	12	729	420	420	0	163	116	30
1952	1,027	20	15	992	476	456	20	171	309	36
1953	1,324	31	19	1,274	491	486	5	220	516	47
1954	1,488	5	24	1,459	536	523	13	273	589	61
1955	1,304	-20	28	1,296	303	283	20	347	577	69
1956	1,274	16	34	1,224	287	278	9	387	473	77
1957	1,675	47	51	1,577	144	114	30	429	859	145
1958	1,770	7	58	1,705	-17	-37	20	424	1,102	196
1959	1,926	-23	75	1,874	470	441	29	288	860	256
1960	2,158	22	86	2,050	299	249	50	155	1,138	458
1961	2,381	34	152	2,195	164	89	75	-143	1,728	446
1962	2,356	30	197	2,129	424	300	124	-459	1,818	346
1963	2,560	6	209	2,345	362	410	-48	-500	2,113	370
1964	3,040	-2	273	2,769	554	520	34	-404	2,161	458
1965	3,294	6	352	2,936	234	123	111	-275	2,301	676
1966	4,226	51	488	3,687	122	-38	160	-144	2,939	770
196.	4,093	91	670	3,332	-817	-950	133	-75	3,737	487
1968	4,820	143	1,317	3,360	381	-244	625	-24	2,644	359
1969	5,488	-128	1,788	3,828	-328	-484	156	-51	3,994	213
1970	6,393	122	2,137	4,134	-408	-333	-75	-299	4,496	345
1971	6,554	95	3,185	3,274	-1,155	-1,208	53	120	3,941	368
1972	8,491	262	3,677	4,552	262	-299	561	-123	4,231	182
1973	9,480	386	3,411	5,683	140	-1,089	1,229	-338	5,210	671
1974	9,697	453	2,569	6,675	326	-923	1,249	-708	6,496	561
1975	11,307	-351	2,388	9,270	1,626	955	671	957	6,847	-160
1976	13,112	-32	3,116	10,028	3,099	1,517	1,582	1,420	5,319	190
1977	15,715	269	3,659	11,787	5,557	2,569	2,988	184	5,589	457
1978	19,854	1,069	2,735	16,050	6,376	3,829	2,547	410	8,591	673
1979	16,800	1,300	4,300	11,200	6,500	4,000	2,500	-100	4,100	700
1980	24,900	500	6,300	18,200	7,400	4,500	2,800	200	9,300	1,300

Source: Federal Reserve Boar.

Mortgage Pools: Prohibited Transactions Under ERISA

by William J. Chadwick

Introduction

For a number of legal and economic reasons, fiduciaries responsible for the investment of assets held in connection with Taft-Hartley and corporate retirement plans are interested in investing in real estate. There are a number of ways of participating in the real estate market. Briefly stated, employee benefit plans may take an equity position or a debt position in the real estate market.

One way of taking a debt position in the real estate market is by purchasing one or more certificates of interest in a mortgage pool investment trust, the corpus of which consists of interest-bearing obligations secured by mortgages or deeds of trust on real property. These so-called pass-through certificates have become extremely popular.

Like all other investment decisions made by employee plan fiduciaries, such as trustees and investment advisors, an investment in pass-through mortgage pool certificates must be scrutinized to determine whether any aspect of the acquisition and holding of such certificates will result in non-exempt prohibited transactions under ERISA. The purpose of this article is to discuss mortgage pool investment trusts and the application of the prohibited transaction provisions contained in ERISA to such trusts. In this regard, the article contains a discussion of the class exemption from the prohibited transaction restrictions recently granted by the Department of Labor for certain transactions involving mortgage pool investment trusts (PTE 81-7).

Mortgage Pools

Mortgage pools may be structured in a number of ways. However, without regard to structure, mortgage pools seem to have certain common characteristics. For purposes of discussing and applying the prohibited transaction restrictions contained in ERISA, this article will use a generalized model with common characteristics.

A mortgage pool is an investment pool. The corpus of the pool consists of interest-bearing obligations (i.e., notes) secured by mortgages or deeds of trust on real property. The notes are either originated by the sponsor of the mortgage pool or by other mortgage lenders or acquired from mortgage brokers or other third parties. Once originated or acquired by the pool sponsor, the notes are sold or otherwise transferred to a trust in exchange for a fixed price.

This transfer is usually also accompanied by a "servicing" or other similar arrangement between the pool sponsor and the trust pursuant to which the pool sponsor, in exchange for a fee or retained interest, agrees to collect and remit payments and otherwise service the mortgages or deeds of trust for the trust. Although the trust technically issues undivided interests in a mortgage pool (i.e., pass-through certificates) to investors in order to raise the sums necessary to purchase the pooled mortgages, the pool sponsor or an affiliate may act as an underwriter in connection with that effort.

As indicated above, the pool sponsor or other originator [illegible] notes transferred to the mortgage pool usually enters into a servicing and maintenance agreement with the trust, pursuant to which the originator and the trustee allocate responsibilities for the administration of the mortgage pool. In addition, the pool sponsor typically makes certain warranties and representations relating to the pooled notes. For example, the pool sponsor will typically represent that each note constitutes a valid first or second lien on the real property securing the note and that the pool sponsor had good title to the note prior to its transfer to the trustee.

Subsequent to the creation of the mortgage pool, the operation of the mortgage pool may result in the holding by or for the pool of real property formerly securing the notes transferred to the mortgage pool. Such real property is acquired by the mortgage pool through foreclosure. In addition to notes and real property, the operation of the mortgage pool will result in the holding of cash by or for the mortgage pool.

Prohibited Transaction Provisions

Overview. A thorough discussion

of the prohibited transaction provisions contained in Sections 406 through 408 of ERISA and the parallel provisions contained in Section 4975(c)(1) of the Internal Revenue Code is beyond the scope of this article. However, it is important to note that, as a general rule, prohibited transactions may arise in three contexts. First, the sale of pass-through certificates in a mortgage pool investment trust to certain employee benefit plans may be prohibited. Second, certain aspects of the administration and management of mortgage pool investment trusts may be prohibited. Third, solely because an employee benefit plan owns a pass-through certificate, certain postacquisition transactions having nothing to do with the mortgage pool investment trust may be prohibited. Below, this article outlines some of the possible prohibited transactions.

Sale of Certificates. As indicated above, employee benefit plans are interested in acquiring pass-through certificates. In some cases, the sponsor of a mortgage pool investment trust or the trustee, though independent of each other, may have a preexisting relationship with an employee benefit plan acquiring a pass-through certificate. Where the pool sponsor, the trustee or one or more of their respective affiliates have investment discretion with regard to the assets of an employee benefit plan investor, the pool sponsor or the trustee and/or such affiliate may be a fiduciary with respect to the plan.

Alternatively, where the pool sponsor, the trustee or one or more of their respective affiliates provide services unrelated to the particular mortgage pool investment trust to investing plans, the pool sponsor, the trustee and/or such affiliate may be a service provider. As a result, a direct or indirect sale of pass-through certificates by the pool sponsor, the trustee or one or more of their respective affiliates to employee benefit plan as to which the pool sponsor, the trustee or any of their respective affiliates is already a fiduciary or a service provider may be a prohibited transaction under Section 406(a)(1)(A) of ERISA, which prohibits the direct or indirect sale, exchange or transfer of property between a plan and a party in interest.

In addition, where the pool sponsor, the trustee or one or more of their respective affiliates is a plan fiduciary, such transaction may be prohibited under Section 406(b)(1) and (2) of ERISA, which prohibits a fiduciary with respect to a plan from dealing with the assets of the plan in its own interest or for its own account and from acting in any transaction involving the plan on behalf of a party (or representing a party) whose interests are adverse to the interests of the plan or its participants or beneficiaries.

An employee benefit plan may acquire one or more pass-through certificates in a mortgage pool investment trust at a time when no preexisting party-in-interest relationship exists between such plan and the pool sponsor or the trustee. However, if the initial acquisition of pass-through certificates by such plan results in the characterization of the assets of the mortgage pool investment trust as "plan assets," a characterization that will be discussed below, the pool sponsor or the trustee may be classified as parties in interest with respect to such plan. As a result, the acquisition of pass-through certificates in a subsequently established mortgage pool investment trust may be a prohibited transaction under Section 406(a)(1)(A) of ERISA, which prohibits the direct or indirect sale, exchange or transfer of property between a plan and a party in interest.

Administration/Management of the Mortgage Pool Investment Trust. Other prohibited transactions may arise after the sale of pass-through certificates to employee benefit plan investors. In connection with the administration and management of mortgage pool investment trusts, the pool sponsor and the trustee may be classified as fiduciaries or service providers. However, the roles played by the pool sponsor and the trustee will only result in their classification as fiduciaries and service providers if the assets of a mortgage pool investment trust constitute "plan assets."

In connection with the issue of whether the assets of a mortgage pool investment trust constitute "plan assets," it is important to note the pendency of the proposed and the reproposed regulations relating to plan assets. In addition, it is important to note Prohibited Transaction Exemption 81-7 (PTE 81-7), which will be discussed in detail below.

In particular, in connection with PTE 81-7, as an alternative to exemptive relief, the applicants for that exemption requested the Department of Labor to issue an advisory opinion that ownership of pass-through certificates in a mortgage pool investment trust by an employee benefit plan does not mean that the mortgage loans in the pool are plan assets. However, the Department stated that, at that time, it was not prepared to conclude that such mortgage loans would not be plan assets due to the pendency of the proposed regulations relating to plan assets. The Department decided to grant the requested class exemption.

The Author

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but it noted that the relief provided in the class exemption may ultimately be affected by the actions taken by the Department regarding the proposed regulations.

At this time, the proposed regulations have not been finalized. Thus, it is still unclear whether the assets of a mortgage pool investment trust constitute plan assets. As a result, you should proceed in this area on the assumption that the assets of a mortgage pool investment trust constitute plan assets until the Department reaches a conclusion to the contrary.

Sponsor Retains Interest

Based on the assumption that the assets of a mortgage pool investment trust constitute plan assets, the administration and management of such trusts may result in numerous non-exempt prohibited transactions. For example, in connection with most mortgage pool investment trusts, the pool sponsor will retain a portion of the interest paid by individual mortgagors as compensation for servicing the mortgages. However, the amount of interest retained by the pool sponsor as a servicing fee may also reflect an attempt to balance money market yield considerations with the aggregate yield of the pooled mortgage loans.

Under such circumstances, the retention of interest by the pool sponsor may be a direct or indirect transfer to or use by or for the benefit of a party in interest, of plan assets, a prohibited transaction pursuant to Section 406(a)(1)(D) of ERISA. In addition, when the pool sponsor or an affiliate of the pool sponsor is also a fiduciary with respect to an employee benefit plan investor, the retention of interest may be a prohibited transaction pursuant to Section 406(b)(1) of ERISA, which prohibits a fiduciary with respect to a plan from dealing with plan assets in its own interest or for its own account.

In the course of servicing the mortgage loans included in a mortgage pool investment trust, the pool sponsor may receive certain additional fees such as late payment charges from mortgagors. If the pool sponsor is also a fiduciary with respect to an investing plan, the retention of such fees by the pool sponsor may be a prohibited transaction pursuant to Section 406(b)(1) of ERISA. Such a transaction may also be prohibited pursuant to Section 406(b)(3) of ERISA, which prohibits a fiduciary from receiving any consideration from any party dealing with the plan in connection with a transaction involving plan assets.

Problem With Collection Practices

In some cases, the pool sponsor also collects and holds individual mortgage payments in non-interest-bearing trust accounts until the designated date of disbursement to certificate holders. This practice may be prohibited under Section 406(a)(1)(D) of ERISA.

Under some servicing agreements, the pool sponsor is either required or permitted to advance funds to pass-through certificate holders equal to the aggregate amount of payments of principal and interest (adjusted to the applicable pass-through rate), which are delinquent on a distribution date, subject to such advances being reimbursable under insurance contracts, etc. Such advances may be prohibited under Section 406(a)(1)(B) of ERISA as loans or extensions of credit between a plan and a party in interest.

In connection with most mortgage pool investment trusts, both the pool sponsor and the trustee provide numerous services to the mortgage pool investment trust. If the pool sponsor or the trustees were, by reason of pre-existing relationships, parties in interest with respect to any employee benefit plan certificate holder, the rendering of any additional services by either such party to the employee benefit plan may constitute a prohibited transaction in violation of Section 406(a)(1)(C) of ERISA, which prohibits the furnishing of goods, services or facilities between a plan and a party in interest.

Transfer of Notes

In connection with the transfer of notes to a mortgage pool, it is possible that a note will be secured by property owned by a party in interest, for example an employee participant, with respect to an employee benefit plan that later acquires an interest in the mortgage pool investment trust. The purchase of an interest in the mortgage pool investment trust by such a plan may be an extension of credit between the plan and a party in interest, which is prohibited under Section 406(a)(1)(B) of ERISA.

In addition, if the pool sponsor subsequently acquires such a property on behalf of the mortgage pool investment trust through foreclosure, the acquisition may constitute the sale or exchange of property between the plan and a party in interest, which is prohibited under Section 406(a)(1)(A) of ERISA. Similarly, the pool sponsor may acquire through foreclosure property leased to a party in interest with respect to a plan with an interest in the mortgage pool investment trust. This may constitute the lease of property between the plan and a party in interest, which is prohibited under Section 406(a)(1)(A) of ERISA.

It is also possible that an employer or employee covered by an employee benefit plan with an interest in the mortgage pool investment trust leases property subject to a note included in the mortgage pool investment trust. Under certain circumstances, the acquisition of such real property through foreclosure by the pool sponsor on behalf of the mortgage pool investment trust may constitute the acquisition, on behalf of an investing plan, of employer real property in violation of Section 407(a) of ERISA. Under Section 407(a) a plan may not acquire or hold any employer real property which is not qualifying real property. The term "qualifying employer real property" is limited to multiple parcels of real property which, among other things, are geographically dispersed.

External Transactions. After the sale of interest in the mortgage pool investment trust to employee benefit plans, other prohibited transactions may arise from transactions between the pool sponsor and its affiliates and investing plans relating to matters that have nothing to do with the mortgage pool investment trust. As indicated above, if the assets of the mortgage pool investment trust are plan assets, the pool sponsor is a fiduciary and each of its affiliates is a party in interest with respect to each investing plan. Among other things, sales of property and the provision of services by affiliates of the pool sponsor to investing plans would be prohibited.

The prohibited transactions noted above are only intended to be illustrative. Numerous transactions inherent in the sale of pass-through certificates, the administration and management of the mortgage pool investment trust and unrelated transactions may be prohibited.

Statutory Exemptions

Because of the breadth of the prohibited transaction restrictions, ERISA contains statutory exemptions from some of the prohibitions. However, most prohibited transactions are not covered by a statutory exemption and most statutory exemptions contain limitations on their scope. For example, most statutory exemptions do not cover fiduciary conflicts of interest. Below, this article outlines some of the statutory exemptions that may cover transactions involving mortgage pools.

Loans to Participant

Section 408(b)(1) of ERISA contains an exemption for loans made by a plan to a plan participant provided certain conditions are satisfied. For example, loans must be available to all plan participants on a reasonably equivalent basis and, if a loan is made, it must bear a reasonable rate of interest and it must be adequately secured. Arguably, the statutory loan exemption covers indirect loans to plan participants through a mortgage pool. However, the statutory loan exemption was only intended to cover direct loans by a plan to a plan participant against the plan participant's vested accrued benefit or account balance.

Section 408(b)(2) of ERISA contains an exemption for the provision of services by a party in interest to a plan provided certain conditions are satisfied. For example, the services must be necessary for the operation of the plan. The statutory service provider exemption covers a number of transactions resulting from the provision of services by the pool sponsor to the mortgage pool when the pool sponsor is a party in interest with respect to an investing plan. However, the statutory service provider exemption does not cover fiduciary conflicts of interest.

Section 408(b)(4) of ERISA contains an exemption for the deposit of plan assets in a bank or similar financial institution when such bank or other financial institution is a fiduciary provided certain conditions are satisfied. For example, the investment must be expressly authorized by a provision of the plan. The statutory bank deposit exemption may be helpful to the bank trustee of a mortgage pool.

Provision of Ancillary Services

Section 408(b)(6) of ERISA contains an exemption for the provision of ancillary services by a bank or similar financial institution to a plan if such bank or other financial institution is a fiduciary provided certain conditions are satisfied. For example, the bank or financial institution must adopt adequate internal safeguards which assure that the providing of such ancillary services are consistent with sound banking and financial practice. Again, the statutory ancillary services exemption, like the statutory bank deposit exemption, may be helpful to bank trustees. However, with respect to the bank trustee, services relating to the mortgage pool may not constitute ancillary bank services.

Section 408(b)(8) of ERISA contains an exemption for transactions between a plan and a pooled investment fund maintained by a party in interest which is a bank or trust company provided certain conditions are satisfied. For example, the transaction must be expressly permitted by the instrument under which the plan is maintained. The statutory pooled fund exemption is limited to banks and trust companies. In addition, it does not cover fiduciary conflicts of interest.

Reasonable Compensation Allowed

Section 408(c)(2) of ERISA permits a fiduciary to receive reasonable compensation for services rendered. When the pool sponsor is a fiduciary with respect to a plan which has purchased certificates in a sponsored mortgage pool, the retention of certain fees should be covered by this statutory interpretation. However, this statutory interpretation does not cover fiduciary conflicts of interest and, as a result, it is of limited utility.

Section 408(e) of ERISA contains an exemption for the acquisition or sale by a plan of qualifying employer securities and for the acquisition and lease by a plan of qualifying employer real property. The term *qualifying employer securities* includes securities issued by an employer of employees covered by the plan or an affiliate of such employer provided such securities constitute stock or marketable obligations. While the term *marketable obligation* includes notes and other evidences of indebtedness, such notes must be acquired either on the market, from an underwriter, or directly from the issuer. In addition, not more than 25% of the note can be held by the plan.

As a practical matter, the statutory employer securities exemption is not very useful. The term *qualifying employer real property* includes real property leased to an employer of employees covered by the plan or to an affiliate of such employer. However, as noted previously, there must be a substantial number of geographically disbursed parcels. The statutory employer real property exemption is not very useful.

Administration Class Exemption: 81-07

Because of the number of non-exempt prohibited transactions resulting from the formation and servicing of mortgage pools, the Department of Labor granted a prohibited transaction class exemption for certain transactions involving mortgage pool investment trusts. PTE 81-07 contains exemptions for three categories of transactions: (1) the sale of mortgage pool certificates between the pool sponsor and the plan when the pool sponsor, trustee or insurer is a party in interest with respect to the plan; (2) all transactions in connection with the servicing and maintenance of the mortgage pool; (3) all transactions with persons who are deemed to be parties in interest with respect to a plan solely because the plan owns an interest in the mortgage pool. The exemptions are conditional. This article will discuss each exemption below.

Section I(A) and (B) contains an exemption for the direct or indirect ***sale, exchange or transfer*** of mortgage pool certificates between the pool sponsor and the plan when the sponsor, trustee or insurer is a party in interest with respect to the plan and for the ***continued holding*** of such certificates by the plan. If the pool sponsor, trustee or insurer is a party in interest (other than a fiduciary with respect to the plan assets invested in the certificates), there are two conditions (and the five conditions contained in Section II). First, the plan must not pay more than fair market value for the certificates it acquires. Second, the rights and interests evidenced by the certificates purchased by the plan must not be subordinated to the rights and interests evidenced by other certificates of the same mortgage pool.

Five Requirements

However, if the pool sponsor, trustee or insurer is a fiduciary with respect to the plan assets invested in the certificates purchased by the plan, five additional conditions must be satisfied (and the five conditions contained in Section II). First, the decision to purchase the certificates must be made by an independent plan fiduciary. Second, the plan cannot pay more for the certificates than an unrelated third party would pay. Third, no investment management, advisory or underwriting fee or sales commission or similar compensation can be paid to the pool sponsor with regard to the sale of certificates. Fourth, the plan must not purchase more than 25% of the issue. Fifth, at least 50% of the issue must be acquired by persons independent of the plan sponsor, trustee or insurer.

Section I(A) and (B) does not cover transactions in the secondary market. In addition, the third condition relating to fiduciary transactions (i.e., the limitation on compensation paid to the pool sponsor) was included to prohibit the payment by a plan to a plan fiduciary of double fees for the same services. It is not intended to prohibit fees for different services.

Servicing and Maintenance

Section I(C) contains the exemption for all transactions in connection with the ***servicing and maintenance of the mortgage pool.*** This exemption was designed to cover transactions occurring as a result of the internal functioning of the mortgage pool. Two conditions must be satisfied (and the five conditions contained in Section II). First, the transactions must be in accordance with the terms of a binding, pooling and servicing agreement. Second, the agreement must be made available to investing plans before they purchase certificates.

Section I(D) contains the exemption for all ***other transactions*** to which the prohibited transaction restrictions would otherwise apply merely because a person is deemed to be a party in interest with respect to a plan who provides services to the plan. This exemption is intended to provide relief for situations in which prohibited transactions may arise solely because a plan owns a pool certificate. For example, subsequent to purchasing a pool certificate, a plan may have dealings with an affiliate of the pool sponsor regarding matters having nothing to do with the mortgage pool.

General Conditions

Section II contains ***general conditions*** applicable to all transactions covered by Section I(A) through (D). First, the pool sponsor and the trustee must maintain a system for insuring or otherwise protecting the pooled loans and the security for such loans and for indemnifying certificate holders against reductions in pass-through payments. The minimum amount for such coverage must not be less than the greater of 1% of the aggregate principal balance of the covered loans or the principal balance of the largest covered loan.

Any method of accomplishing this level of protection is acceptable. In this regard, it is important to note that the trust may be able to self-insure the mortgage pool. Alternatively, the pool sponsor can purchase insurance from an affiliate. Second, the pool trustee must not be an affiliate of the pool sponsor. Third, the total compensation paid to the pool sponsor must not be more than adequate consideration.

The first condition (i.e., insurance and indemnification) must be related to the definitions, which will be discussed below. In particular, the 1% minimum amount was developed with reference to first mortgages on single-family, residential property, with respect to which there was a considerable amount of experience data. If a mortgage pool is structured to include junior lien loans (e.g., second mortgages) and/or commercial or industrial properties, the Department of Labor may require an increase in the minimum amount and/or it may limit the acceptable methods of providing the required level of protection.

Definitions With Limitations

Section III contains ***definitions*** for purposes of the exemptions. As a practical matter, the definitions contain limitations on the methods of structuring mortgage pools. For example, the term "mortgage pool" means an investment pool the corpus of which is held in trust and consists solely of interest-bearing obligations secured by ***first mortgages or deeds of trusts on single-family, residential property.*** A mortgage loan collected by the pool sponsor must be transferred ***in trust to a trustee.*** Corporations and limited partnerships will not satisfy this definition.

While mutual funds and real estate investment trusts may be funds and real estate investment trusts may be formed as trusts, these entities

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will probably not satisfy the definitional requirements. As stated previously, the trustee must be independent of the pool sponsor. The security for the notes transferred to the trust must be first mortgages or deeds of trust. Junior lien loans are not covered.

Single Family Residential Property Stipulated

In addition, the first mortgages or deeds of trust must be on single-family, residential property. Single-family mortgage loans are permanent loans (rather than construction or land development loans) secured by mortgages on non-farm property comprising one to four dwelling units. While condominiums are included, commercial and industrial properties are not covered.

Another example involves the interests in the mortgage pool. The exemptions apply to "mortgage pool pass-through certificates." Such certificates are defined as certificates representing a beneficial undivided fractional interest in a mortgage pool and entitling the holder of such certificate to pass-through payments of principal and interest from the pooled mortgage loans, less any fees retained by the pool sponsor.

Forward Placements Not Covered

The exemptions do not cover forward placements or forward commitments. According to the Department of Labor the structure of the mortgage pool investment trust exemption is predicated upon the provisions of a servicing agreement referring to a specific pool. To the extent that forward placements or forward commitments involve transactions which precede the formation of a mortgage pool, such transactions are beyond the scope of the exemptions.

Similarly, the exemptions do not cover the issuance of debt securities to finance mortgage purchases. In addition, the exemptions do not specifically cover mortgage-backed bonds. However, because of the similarities between mortgage pool pass-through certificates and mortgage-backed bonds, it may be possible to convince the Department of Labor to grant an exemption for such securities.

Conclusion

For a number of legal and economic reasons, the acquisition and holding of pass-through certificates in a mortgage pool investment trust may be viewed as an attractive investment for Taft-Hartley and corporate retirement plans. However, this type of investment raises a number of prohibited transaction issues. While the statutory and the administrative exemptions provide some relief from the prohibited transaction restrictions, the statutory exemptions do not provide complete relief and PTE 81-7 is limited in a number of ways. In particular, PTE 81-7 is limited to mortgage pools involving single-family residential properties.

In the future, it is anticipated that the Department of Labor will grant additional exemptions for mortgage pool transactions. However, until that time, fiduciaries and other persons involved in mortgage pool transactions must be sensitive to the application of ERISA's prohibited transaction restrictions. ●

Senator NICKLES. Thank you, Mr. Doehler.

Mr. Lewis?

Mr. LEWIS. I am a partner in the firm of Silverstein & Mullens. I am accompanied by Deborah I. Miller, director of labor relations for NAHB.

I will summarize briefly our prepared written testimony. In that testimony, we described in some detail the current depression that faces the housing industry, which is probably the worst in 40 years, but I will not go into that at the present time.

Presently, pension plans face substantial legal impediments toward mortgage investments. The practical effect of these rules has been to put a straitjacket on many types of plan investments, especially mortgage investments. A plan that commits a prohibited transaction, even if it does so innocently, is nevertheless equally guilty under ERISA and will suffer the same consequences as a plan that deliberately engages in a prohibited transaction. Because the definition of "parties-in-interest" under ERISA is so broad, mortgage loans involve a significant risk of inadvertently being a prohibited transaction. Plans that wish to engage in these types of investment consequently must undertake a much higher degree of scrutiny to insure that no parties-in-interest are involved in the transaction. This higher duty and greater cost imposed on plans that wish to make mortgage investments has the practical result of eliminating mortgage investments from the investment portfolio of most plans. Less than 3 percent of plan assets are currently invested in mortgages, principally because of these artificial legal impediments, not because mortgages are economically unsound. In fact, mortgages are historically a superior form of investment, as Senator Lugar's testimony, and our prepared statement have demonstrated.

In 1974, when Congress passed ERISA, and the prohibited transaction rule, it contemplated that administrative exceptions would be provided so that economically sound transactions could continue to be conducted, notwithstanding these overly broad restrictive rules. Unfortunately, this procedure has proved highly unworkable in practice. The Labor Department is extremely slow, and unnecessarily restrictive in granting exemptions. NAHB applied for the class exemption over 1½ years ago that would permit plans to make investments in mortgages. Only after 1½ years of consideration has the Labor Department proposed an exemption and the exemption as proposed is entirely inadequate. As proposed, the exemption essentially precludes mortgage investments through the use of mortgage bankers who are currently responsible for originating at least 20 percent of all mortgages. Also, the proposed exemption is very limited in its potential application. The Labor Department exemption as proposed only applies to employees, not to other parties-in-interest. Consequently, it would not solve the fundamental problem of the excessive cost and risk of a prohibited transaction. Further, the Labor Department has retained so many restrictions in the way in which a plan must place the mortgage in order to qualify for the exemption that the exemption in effect becomes useless. In short, the administrative exemption procedure has proven to be both time consuming, expensive, and inadequate.

NAHB therefore feels that only through prompt legislative action can adequate relief for the housing industry be obtained.

NAHB particularly endorses the testimony of earlier witnesses who have requested repeal of section 406. Those views have already been adequately described. Because of the need for prompt action, we wish to focus on two presently pending bills, S. 1541 and S. 1678.

NAHB supports the improvements in the prohibited transaction rules of ERISA that would be enacted under S. 1541. Eliminating the total prohibitions against dealings between parties-in-interest and plans would be a substantial improvement in the law. NAHB believes, however, that S. 1541 does not go far enough to solve the problems in the housing industry. Plans are traditionally cautious in their investments and the continuing risk of violating the prohibited transaction rules will undoubtedly still have an inhibiting effect on plan investments in mortgages. The presence of requirements concerning interest rates that must be charged will cause many plan fiduciaries to fear that they will be subject to hindsight agency review. As a result, investment in mortgages will still bear a significant risk not present with other investments. Consequently, we feel that S. 1541 offers a substantial improvement in ERISA but feel that it does not go far enough in reducing the artificial ERISA barriers and restoring to plan trustees the authority to determine plan investments based on purely economic considerations.

S. 1678 goes further in the direction the NAHB feels is necessary at the present time. This bill would eliminate the prohibited transaction restriction on mortgage investments and provide plans with a safe harbor under which they could be certain that mortgage investments would not be subject to hindsight review by the Department of Labor and the Internal Revenue Service. Basically, S. 1678 would provide that if mortgage investments are consistent with normal commercial standards and that the interest rate charged to the borrower satisfies one of three specified standards, the mortgage will not be a prohibited transaction under ERISA and will be deemed a prudent investment. By largely eliminating the discretionary role of the Labor Department in reviewing these types of investments, S. 1678 goes the furtherest in the direction of removing the artificial constraints created by ERISA. We therefore urge that S. 1451 be expanded to incorporate provisions similar to those contained in S. 1678 that specifically provide safe harbors for plan investments in mortgages. NAHB urges that prompt attention be given to this most severe problem.

We thank you very much for your consideration.

Thank you.

[The prepared statement of Mr. Lewis follows:]

Statement
on Behalf of the National Association of Home Builders of the United States

Before the Subcommittee on Labor
of the U.S. Senate Committee on
Labor and Human Resources

Hearings on S.1541

January 26, 1982

My name is Stuart M. Lewis. I am a partner in the firm of Silverstein and Mullens and counsel to the National Association of Home Builders (NAHB). I am accompanied by James Schuyler, Vice President and Legislative Counsel for NAHB and by Deborah I. Miller, Director of Labor Relations for NAHB. We are pleased to be here to testify on S.1541 and S.1678, two bills that are of the utmost importance not only to the homebuilders, but also to the economy of the entire nation.

The National Association of Homebuilders, with its affiliated state and local organizations, has a membership of approximately 120,000 homebuilders and individuals working in related fields.

We are the largest organization representing homebuilders in the United States. Our members are annually responsible for the construction of approximately 67 percent of all new homes.

I. The Problem

The housing industry today is in a severe depression due largely to the high rates of mortgage interest and the shortage of residential mortgage money. The shortage of mortgage investment capital at reasonable rates results in significant part from the disintermediation suffered by the thrift institutions because of bond, money market fund and certificate of deposit yields. Thrift institutions have been the principal supporters of the residential mortgage market for over forty years. Today's interest rates have priced many middle-income families and first-time buyers out of the housing market causing the housing industry to suffer its worst economic downturn in 40 years. Through last November the housing industry has suffered thirty-seven months of consecutive decline.

New housing production for 1981 was the lowest since 1946 -- only 1,087,000 units were produced. New home sales in 1981 were the lowest ever recorded. The existing home market has been similarly affected with a monthly sale rate that has declined from about 4 million single family homes in 1978 to below two million at the present time.

Last year the failure rate among construction firms was up 41 percent -- and among subcontractors, up 120 percent. The unemployment rate in the construction industry is now 18.1 percent. This is more than twice the national average. At the beginning of this year, the number of unemployed construction workers will rise to well over one million persons.

NAHB estimates that the downturn has cost the American economy more than 2.8 million man years of employment, $49.2 billion in wages and $15.7 billion in total tax revenues, a combined impact of $223 billion.

If these statistics are not sufficient to make the actual devastation to our industry clear, the results of a recent survey of NAHB's membership is a poignant revelation of the extent of the hardship. Of those polled, only 25 percent said they were experiencing profits. Twenty five percent said they were breaking even, and 50 percent indicated they were in the red. Of those who were losing money, the average time for which they estimated they could survive was only eight more months.

Of all the housing cycles since the end of World War II, this downturn is the longest and the most difficult that the housing industry has ever experienced. If something is not done immediately to open up new sources of mortgage investment capital and to bring down high interest rates, contractors will go under in droves and the numbers which I have cited today will rise exponentially.

Another facet of this problem involves the current movement to eliminate the distinctions between savings and loan associations and banks.

Savings and loans have historically been the single major source of long-term stable mortgage funds. As financial institutions are restructured the availability of thrift institutions as a source of stable, long-term mortgage financing is jeopardized. Historically pension funds have invested less than three percent of their assets in mortgages, including commercial mortgages. In the future, however, pension funds will be the only major stable source of long-term mortgage financing. It is imperative to the housing industry and the American economy that unnecessary legal impediments to mortgage investments by pension funds be removed.

For these reasons, NAHB is grateful for the opportunity to present its views on two bills that may begin to solve these problems by removing artificial barriers created under our pension laws that have substantially inhibited the nation's employee pension funds from investing in home mortgages. We must stress, however, that the severe plight of the housing industry requires immediate, forceful action from Congress. Further, NAHB submits these issues should be resolved before Congress moves any further toward restructuring thrift institutions.

II. Current Law

Sections 404 through 408 of ERISA establish standards which were designed to: (1) encourage safe and sound investments yielding acceptable returns that are in the best interests of the plan participants, and (2) protect pension plan participants from improper dealings by plan fiduciaries and other parties in interest.

The Congressional assumption behind the adoption of these provisions in 1974 was that dealings between pension funds and related parties are inherently subject to abuse. Because it is difficult to police these types of transactions, Congress enacted a general prohibition on all dealings between funds and related parties. Unlike most investment transactions, mortgage transactions usually involve a large number of parties including not only employers and employees but also builders, developers, unions, mortgage bankers and other types of financial institutions. Because of the large number of parties in interest typically involved in mortgage transactions, a mortgage investment is more likely to be classified as a prohibited transaction than other types of investments. Plan trustees are inhibited from engaging in such transactions because there is a significant risk that they might inadvertently engage in a prohibited transaction. Thus, as a practical matter, the ERISA prohibited transaction provisions preclude plan investments in mortgages, even if the transactions are fair and at arm's length.

In recognition that these overly restrictive prohibition provisions preclude transactions that do not involve abuse, Congress established special administrative procedures for obtaining relief from the prohibited transaction restrictions by petitioning the Labor Department. Unfortunately, that administrative exemption procedure has proved unworkable in operation. Obtaining a prohibited transaction exemption through the Department is extremely difficult. Such exemptions are only obtained after months and sometimes years of delay and often involve expense that is well beyond the means of small plans. For example, in June of 1980, NAHB submitted an application for a class-wide exemption that would allow plans to invest assets in residential mortgages under certain conditions. On December 3, 1981, a prohibited transaction exemption was finally proposed. A comment period was to have expired on January 4, 1982, but was then extended to February 3, 1982. We do not know how long it will take the Department to issue an exemption following the close of the comment period.

III. Solutions

Given this problem and the need to press for immediate relief, only three options appear to offer a prospect for significant improvement. I will describe each of these options below.

A. Proposed Prohibited Transaction Exemption

In response to the application of NAHB and the application of the National Coordinating Committee for Multiemployer Plans (NCCMP), as I mentioned earlier, the Department of Labor, on December 2, 1981, issued a notice of a proposed class exemption for transactions involving certain residential mortgage financing arrangements (Applications D-1937, D-2004). Unfortunately, this proposed Exemption, in addition to the delay in its issuance, fails to recognize the realities of the mortgage market and is far too restrictive to provide the type of relief required at this time.

First, the proposed exemption essentially precludes mortgage bankers from participating in exempt mortgage transactions. This is so despite the fact that under current practice, mortgage bankers are responsible for originating at least 20 percent of all mortgages.

Secondly, under the proposed exemption, transactions involving all parties in interest except employees would still be prohibited. As a result, trustees would be required to perform the arduous administrative task of identifying parties in interest and most likely, they would still be reluctant to make mortgage investments for fear of inadvertent prohibited involvement with parties in interest.

Thirdly, although the proposed exemption requires that an independent financial institution make all mortgage loan decisions on behalf of the plan, the proposed exemption still requires that plan trustees who have any association with the residential units being purchased, remove themselves from any involvement with regard to the decision of the plan to invest in mortgages. This is not only an unnecessary burden which provides no additional protection, but it will also effectively preclude smaller plans from making mortgage investments. Typically, with smaller plans, the builder/developer is the plan trustee and makes the decision to invest in a particular medium such as mortgages. Under the exemption, such a trustee would be required to step aside as to such decisions. This is largely unworkable as an administrative matter, since smaller plans have neither the financial resources nor the legal expertise to conform to these requirements.

Furthermore, it appears that the proposed exemption would require at least two financial institutions to be involved in every mortgage investment transaction rather than just the one that would be required normally.

NAHB is requesting that the Department of Labor substantially revise these restrictions and broaden the application of the exemption.

B. S.1541

The broad prohibitions on transactions between plans and parties in interest as set out in section 406 of ERISA, when applied to the typical investment transaction in which most plans engage, impose an enormous burden on plan trustees. As discussed above, the burden is even greater where the investment contemplated involves a mortgage transaction. Based on our experience, this burden is not mitigated by the exemption process, nor is it offset by any benefit derived from avoiding transactions with non-fiduciary parties in interest. The existing regulation of the conduct of parties in interest who are not fiduciaries is clearly too broad.

We support S.1541 because it represents a significant step toward easing the burden of section 406. It amends 406 to provide more workable standards concerning which transactions are prohibited between plans and parties in interest. S. 1541 would not prohibit transactions between plans and parties in interest if the tests of adequate consideration, security, and reasonable rates of interest are met. In the mortgage investment situation, this would mean that a mortgage transaction involving a plan and parties in interest would not be prohibited if the consideration for the mortgage and the collateral securing the mortgage were adequate and the rate of interest charged to the borrower were consistent with the fiduciary duty standards outlined in section 404 of ERISA.

In order to resolve the unique problems associated with investment in the mortgage market, provisions in addition to those contained in S.1541 are required. Specifically, S.1541 does not exempt all mortgage transactions that meet certain standards. Plans wishing to engage in mortgage transactions will still be subject to review and scrutiny on these investments. This oversight authority will have a substantially inhibiting effect on pension plan investments in residential mortgages. Plan trustees will be concerned about hindsight review and consequently can be expected to choose investments that do not have any risk of being treated as prohibited transactions.

While S.1541 offers a substantial improvement of ERISA, it does not go far enough to reducing artificial barriers and restoring to plan trustees the authority to determine plan investments free of paternalistic governmental oversight. If plan trustees are to be given the authority to determine plan investments on economic grounds, all significant risk of an inadvertent prohibited transaction must be removed. S.1541 retains enough risk of a prohibited transaction that plan trustees can reasonably be expected to continue to avoid residential mortgage investments.

C. S.1678

S.1678, introduced by Senator Hatch on September 29, 1981, goes the furthest in the direction that we think is necessary. This bill eliminates the prohibited transaction restrictions on mortgage investments and provides mortgage investments with a safe harbor from the prudent man rule. By adding a tenth statutory exemption to section 408, the bill, if enacted, would remove the risk of prohibited transaction treatment for employee plan investments in home mortgages.

Specifically, the bill requires that investment in home mortgages be authorized by the express terms of the plan, that normal commercial standards apply to the terms of the mortgages, and that the interest rate charged to a borrower satisfy one of three alternative standards designed to insure that the rate is adequate. We believe that these standards, in conjunction with the prohibition against fiduciary self-dealing in section 404(b) of ERISA and the penalties under the Internal Revenue Code, are more than adequate to protect plans and plan participants from any wrongdoing that may potentially exist in situations where transactions occur between plans and parties in interest.

Further, S.1678 creates more definite standards for exemption from prohibited transaction treatment. By minimizing the discretionary role of the Labor Department in reviewing these investments, S.1676 goes further in removing the artificial barriers created by ERISA.

In addition to statutorily exempting mortgage transactions from the realm of prohibited transactions, the bill also corrects a stigma that has attached to mortgage investments as a result of the prudent investment requirements of section 404(a)(1)(B). By amending section 404 to permit fiduciaries to invest plan assets in the residential mortgage market, the bill recognizes that mortgage investments are a stable, high yield, long-term investment which has consistently produced better earnings than comparable fixed-rate securities in recent years. (See Exhibit A, attached).

IV. Conclusion

NAHB and its 120,000 members applaud S. 1541 for making substantial inroads in correcting many of the defects of the existing law. Revision of ERISA, especially with regard to its fiduciary standards and prohibited transaction provisions, is long overdue. We urge that S.1541 be expanded to incorporate provisions such as the ones contained in S.1678 that specificially exempt mortgage transactions and provide mortgage investments with a safe harbor from the prudent man rule. Provisions such as these recognize the realities of the mortgage market place and are essential to removing the artificial barriers that heretofore have limited plan investment in the mortgage market.

NAHB believes that an expanded bill would most adequately provide the type of relief that the housing industry so desperately requires because it would free plans to invest their assets in the mortgage market, as the plan trustees independently determine.

Senator NICKLES. Thank you, Mr. Lewis.

Were you on the west coast for the——

Mr. LEWIS. Yes, I was.

Senator NICKLES. Where they were getting ready to have Paul Volcker for dinner.

Anyway, we appreciate your coming back and leaving that meeting to be with us today, and to give us your expertise.

I will address most of my questions to the panel as a whole, and you can respond to them, but, Mr. Lewis, did you say that 3 percent of the current portfolios of all private pension plans are now in mortgages?

Mr. LEWIS. Based on statistics by Government agencies, it appears that less than 3 percent. The statistics that we have, which are attached to our prepared statement, list mortgages as an investment. They do not distinguish between commercial mortgages and residential mortgages. So that any figure indicated there is high with respect to residential mortgages. Some of the figures indicate that the figure is perhaps around 1 percent.

Senator NICKLES. If we were able to enact S. 1541, or Senator Hatch's bill, as introduced, do you see that percentage increasing dramatically, or somewhat?

Mr. LEWIS. It is our experience, Senator, that the plan trustees, and those making the investment decisions, simply are inhibited from making mortgage investments because of the ERISA constraints. They feel that the extra burden imposed on a mortgage investment under the present rules is such that they will simply choose a simpler investment, a less costly investment, and one that does not involve ERISA, such as stock or bond investment.

If we can put mortgages on a completely economic basis, they are a superior form of investment, and one that is suitable for a plan, which are long-term investment funds, and consequently they would be very suitable, and highly safe form of investment for pension plans.

Senator NICKLES. I was looking at the small percent that was actually going to mortgages, and it seems it would open it tremendously. However, looking historically, prior to ERISA, they did not hold that high of a percentage, according to this schedule. I do not believe in channeling funds, either.

I have some reservations. I would like for mortgages to be able to compete with the other types of investment, so that the portfolio managers, et cetera, can make their decision on what they feel is in the best interest for their participants.

Mr. LEWIS. That is our principle. I would also, Senator, like to simply put mortgages back on an economically competitive basis, so that trustees can decide on the basis of simple market economics, which is the best investment.

If we can remove these legal restraints so that the trustee can make those decisions, we believe that mortgages will compete.

Senator NICKLES. Do you think the changes in S. 1541 that we are making, or trying to make in this involvement will open that up, or do you have some others?

Mr. LEWIS. We believe, as I indicated, that the changes in S. 1541 are a substantial improvement. Presently there is a severe burden. S. 1541 would go a long way to alleviate that extra burden.

However, S. 1678 would go even further, and we believe would be superior in its approach in that it would provide a safe harbor under which a plan trustee can determine mechanically that the investment in a mortgage is one in which he does not have to concern himself with the Labor Department coming in saying, 2 years later, we decided that this was not an appropriate interest rate, or whatever, and we charge you with a prohibitive transaction.

Just that fear, in and of itself, we believe, would be a deterrent to plan trustees making that type of investment, and consequently we prefer the enactment of the safe harbor for the investment.

Senator NICKLES. I have a question for Mr. Johnson.

I am not sure if I heard your statement, but basically, Mr. Johnson, did you say something along the lines of adequate consideration, hoping that we would define it to where it could be less than market value?

Mr. JOHNSON. That is not the intent of our statement, at all. Our statement about adequate consideration was just that it was not the intent of Congress that it be the highest price available at the moment that the transaction was completed in the market at the time. This is needed because the structure of the mortgage market as it works today, and will probably work in the future, is that mortgage transactions are consummated over a time period.

When one deals with an investor, it is done over a certain time frame. I might give you an example. I just placed $20 million in mortgages with a public pension fund, and we did this with a process that took over 6 months. By June we had the terms set. We then went to realtors and builders, and told them what our pricing was. We had agreed with the pension fund that we would deliver the mortgage to them in the fourth quarter of 1981, so that they could then plan their flow of funds, to take those mortgages into investment. So the process occurs over a time line.

Now, during that period, the market moved up, the market moved down. Sometimes the price for those mortgages, if they would have been delivered at any one time in that process, would have been above or below the current market, because the price in fact had been set earlier in a forward delivery contract. That is part of our major consideration—one of eliminating any sort of second guessing on pricing.

Senator NICKLES. I appreciate your clarification. I understand at least where you are coming from now. I was concerned about this definition of adequate.

Mr. JOHNSON. It is a function of the way the market works. It is not a way to try to get subsidized funds out of pension funds. We do not support that.

Senator NICKLES. Mr. Doehler, do you have any comments on that?

Mr. DOEHLER. We support more administrative flexibility to allow pension funds to invest in mortgages. If the Labor Department does not act in the very near future then we believe legislation is needed. Clarity is necessary for market operation, as Doug has just said, and any legislative changes, as Senator Hatch's bill attempts with specific criteria, should not create more complexity for pension fund wanting to invest in mortgages.

The approach in S. 1541, adding more reasonableness to such definitions as what constitutes adequate consideration in the prohibited transaction area, would be beneficial. A first step, however, would be for the Department to come up with regulatory clarity.

I would like to answer the question that you had on the investment and mortgages, because I think it was a key one. You pointed out, through the numbers you cited, that the pension funds are not traditional investors in mortgages. One of the reasons that the mortgage security format was created was to increase the liquidity, of mortgages. The security format allow an investor to disperse risk and obtain levels of protection unavailable from investment in individual mortgages.

Thus, I think an indication that pension funds invest less than 3 percent of their total assets in mortgages, is because the mortgage itself has been in an unweildy type of investment. If the investment vehicle is improved, there is no reason not to expect that pension funds will they make greater investments in mortgages, providing the plan trustees can obtain the ability to do that. A great deal can happen in the market if we get a clarification for pension funds as to their ability to make investments in mortgages and especially mortgage securities.

Mr. JOHNSON. I might add to Steve's comments.

Other reasons are, first that the mortgage security mechanism did not exist, and second that the major holders of mortgages at that time were part of a reasonably healthy thrift industry.

The whole structure of the market for mortgages has been changed forever, and with that comes this gap that I spoke of earlier, and the need for pension money. That did not exist in those earlier years. In fact, mortgages were directed by policy toward the thrift industry, and that is where they resided. Perhaps one could even say they did not always reside there at what would now be considered a market yield or price. It is a completely new game, with most transactions taking place at an established market price.

So market pricing, coupled with eliminating legal restrictions will mean larger flows of capital from the pension markets into mortgages.

Senator NICKLES. It is probably a great deal of the function of the fact that they were not competitive. That is really where I was coming from. But yet today, if you were actually on a competitive basis for the money, you might, because mortgage rates are up considerably over what they had been historically for years. You may be able to actually compete now, whereas in the past, I do not think most portfolio managers would have approached them, and they would have been logical in their justification.

Mr. LEWIS. I think there is some indication that mortgages are more attractive, if you look at the public pension funds, that are not subject to the ERISA law. I do not have any statistics on it. I think there has been a push to have much higher levels of investments by public funds in the mortgage market than private funds, and I believe that—the fact that one group is subject to these restrictions and the other is not, is in large part the difference.

Senator NICKLES. One additional question, particularly for mortgage bankers, but you listened to the Secretary's proposal today for the class exemption.

How did that appeal to you, particularly for your industry?

Mr. JOHNSON. I have talked to Mr. Clayton personally about the contemplated exemptions, and we at MBA generally applaud the effort of the Department of Labor. They have taken great strides recently in working very hard to do several major exemptions to free up capital, but still and yet they are not complete. Because any exemption, as has been stated over and over again, is done as a response to a specific question. The exemption will be granted usually in too narrow terms.

Mr. Clayton spoke today that the contemplated exemptions for the home mortgage market will probably be the broadest ones ever given, and one reason for that is the response that has come in to him from the different trade associations that are interested in the mortgage transaction. We feel that there are major segments missing, from the exemption specifically the ability to do second mortgages and to do "forward" transactions. That is the jargon in the industry for the kinds of delivery that I mentioned that I did with this public pension fund, where the contract was actually written some 8 months before delivery actually took place.

Senator NICKLES. You do not think it has been covered?

Mr. JOHNSON. It has not, sir, not the way we read it.

Senator NICKLES. So it is short in that regard and short in what other regard?

Mr. JOHNSON. There are different types of mortgages. My specific title is vice president for planning and product development, which means I do not do anything for the Chase organization other than try to figure out where we are going to be next year and try to develop new mortgage products. I do not feel that the exemption process has responded to the fact that the mortgage instruments are changing so rapidly. It has not responded adequately, we feel, even to the concept of the second mortgage as an instrument also for investments.

Senator NICKLES. You would want some flexibility, a greater or broader approach which I think was alluded to that they were looking at expanding upon?

Mr. JOHNSON. Yes.

Senator NICKLES. Mr. Lewis, you mentioned a couple of things that were wrong and you were going kind of fast, and maybe it was because of the——

Mr. LEWIS. I thought because you were in a hurry.

Senator NICKLES. I was in a hurry, but could you again highlight what was short as far as their recommendations for the class exemption?

Mr. LEWIS. Yes, sir. There are several problems with the exemption as proposed, and we would first just want to emphasize what the time factor has been in getting what we have gotten so far. It has been 1½ years to get the exemption out in proposed form. Without the introduction of S. 1678, we would have some doubt whether we would be this far along in the process, and we have no idea when it will be finalized. So there is an initial time question of getting the thing finalized.

In addition, we believe the restriction is too narrow, as I indicated.

Senator NICKLES. In what regard?

Mr. LEWIS. In several regards. One is that according to our figures, approximately 20 percent of all mortgages are originated by mortgage bankers. As proposed, the exemption would not apply to that type of mortgage at all. So you cut out 20 percent of the commercial market.

Senator NICKLES. Would not apply to——

Mr. LEWIS. Mortgage banker originated loans. It would only apply to loans that are channeled through savings and loan associations and regulated investment advisers. So they have started off by cutting off a substantial part of the market to begin with.

A second major problem is one of the major reasons that we applied for the exemption. As Mr. Groom pointed out earlier, the overly broad definition of parties-in-interest causes substantial problems, especially in mortgage investments because there are a number—the numbers of parties who can be parties-in-interest is quite broad. The policing activity that a plan must engage in to make sure that it is not committing a prohibited transaction are prohibitive. The Labor Department exemption, as proposed, does not really solve that problem in that they only exempt one group. And if you will recall Mr. Groom's chart, there were four major parties, employers, unions, service providers, and employees. The exemption only applies to employee groups. That leaves three-fourths of the party-in-interest outstanding which means the plans will be burdened with a substantial policing job, which we think will have an inhibiting effect. So the Labor Department has not gone to the fundamental problem of getting rid of these party-in-interest concerns so that plans will still be concerned that they have inadvertently made a loan to someone who is a party-in-interest. They have only cut out one-fourth of the group, and that just does not solve the problem. So that, in effect, makes it more or less useless as far as we are concerned.

Senator **Nickles**. I do not think what they have proposed will end up being useless. I think we are actually looking at something that will be beneficial.

Disregarding what we will do legislatively to your industries, we would solicit your cooperation to work with our staff and to work with the administration as that particular class exemption is moving. It is not finalized yet, so I think it is still ripe for some input. We would solicit your cooperation on this particular exemption to see if we cannot make it as comprehensive and yet still provide the safeguards that we want to provide.

I would somewhat conclude the hearing today with that general thought. Our goal is to provide basic security for those plans, but yet let us eliminate a lot of the needless and somewhat reckless rules and regulations that have been punitive in various industries and actually handicap those managers and, that is, those participants, those employees in those plans from prohibiting them from engaging in various transactions. We are going to endeavor what we can. Whether the legislation be, Senator Hatch's or our bill, it has proved to be very useful working with DOL and letting them know that we are very serious about making some needed changes. I think we have seen some results from that. As we continue to progress, both on S. 1541 and working with the administration, we solicit all persons' input to help make the changes that we can, basically to accomplish the goals that we are all looking for, solid pensions with as little paperwork as possible.

We thank you very much for that. We will be keeping the record open for 2 weeks, and I know that there are other Senators that do have some other questions. We appreciate your early response to those and also to our committee as we continue to work on this legislation.

At this point we will accept for the record all statement of those who could not attend and other pertinent material submitted for the record.

[The following material was received for the record:]

National Association
of Real Estate
Investment Trusts, Inc.

FEB 11 1982

February 9, 1982

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The Honorable Donald L. Nickles
Chairman
Subcommittee on Labor
United States Senate
2227 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Nickles:

Pursuant to your kind invitation, extended in your letter of January 8, [redacted]hat this let[redacted]ement Income [redacted]ntives [redacted]Administrative Simplification Act of 1981.

Although I will not be appearing as a witness, the National Association of Real Estate Investment Trusts, Inc. (NAREIT) wishes to provide your Subcommittee on Labor with information in support of your efforts to consolidate and simplify the administration of the Employee Retirement Income Security Act of 1974 (ERISA).

As President of NAREIT, I present the views of 75 "tax qualified" and 25 nonqualified real estate investment trusts, or REITs, with real estate assets of 5.3 billion dollars, held in the form of equity or mortgage interests in office buildings, rental housing, shopping centers, light industrial structures, and a variety of other properties. As illustrated herein, the diversified portfolios of the industry offer important investment opportunities for Employee Pension Benefit Plans ("plan"). It is our belief that the "prohibited transactions" provisions of Title I, Part 4 and Section 2003 of ERISA have severely and unnecessarily impeded plan investments in real estate through REITs.

1101 Seventeenth Street, N.W., Suite 700, Washington, D.C. 20036-4731 202/785-8717

I. ERISA Effectively Obstructs Pension Plan Access to Valuable REIT Investment Opportunities

In the years subsequent to the enactment in 1960 of tax laws granting favorable status to "qualified" REITs, a number of private and public pension funds have taken advantage of opportunities to invest in the securities of REITs found to be prudent and profitable investments. Yet, for at least the past two and one-half years, the purchase of privately placed REIT securities by pension funds has generally ceased because of regulatory and administrative developments associated with the prohibited transactions provisions of ERISA. Given the depressed condition of the stock market and the extremely high cost of public placement of securities, the result of these developments is the virtual termination of plan investment in REITs.

Specifically, the mutually beneficial investment activity came to an abrupt and unexpected end in August, 1979 when the Department of Labor issued its initial version of proposed regulations defining "plan assets" under ERISA. (Department of Labor Proposed Regulation, 29 CFR §2550.401b-1) Intended to serve as the mechanism for identifying those persons who should bear fiduciary responsibility to the beneficiaries of each pension plan, the proposed regulations would cause the assets of various entities invested in by a plan to be deemed to be assets of the plan itself. In this circumstance, the managers of the entity invested in by the plan would become plan fiduciaries and transactions between that entity and other parties bearing remote relationships to the plan would become "prohibited transactions."

Although the full scope of the regulations has been and remains unclear, a real estate company such as a REIT may, upon placement of securities with a pension plan, become subject to the "plan asset" rules because of mortgage lending activity. 1/ As discussed subsequently, a REIT routinely engages in complex and diverse real estate transactions, and plan asset status may cause REIT trustees to confront the overwhelming problems of identifying a bewildering array of individuals and entities related to a pension plan, and further, ascertaining whether any such related party is involved in some fashion in each transaction. As the holder of interests in numerous, disparate real estate assets, a REIT invested in by a plan may be compelled to scrutinize hundreds of proposed transactions, from the most routine leasing or servicing agreements with respect to an existing property to the myraid of transactions inherent in the development of a major shopping center or office complex. More importantly, the burden of such scrutiny may be compounded many times where, for example, a bank or insurance company group trust representing dozens of pension plans acquires an interest in a REIT. Such group trusts may in fact render circumstances untenable by refusing to disclose the identity of participating plans.

1/ As published in revised form, Proposed Regulation §2550.401b-1(c)(1)(i) exempts from plan assets the assets of an issuer of equity securities to a pension plan if that issuer is "primarily engaged...directly in the management or development of real estate...." 45 Fed. Reg. 38085 (June 6, 1980). An exemption is also available if the plan purchases a security that is widely held, freely transferable and registered under the Securities Act of 1933 or the Securities Exchange Act of 1934. 29 CFR §2550.401b-1(e)(2), 45 Fed. Reg. 38086 (June 6, 1980).

Failure to identify and avoid a "prohibited transaction" would expose the REIT trustee to personal liability for plan losses on the transaction, and the related party may be obligated to pay a substantial excise tax on the amount of that transaction. Such liability may arise regardless of the good faith of the parties and due to past, present, or future events beyond their control. Furthermore, plan fiduciaries may themselves have cause for concern, because of exposure to personal liability or because plan integrity and operational flexibility may be degraded by the threat of a REIT's breach of the rules.

In such an environment, REITs are effectively precluded from privately placing securities with a pension plan, and plans are in turn unable to obtain the prudent and rewarding REIT investment opportunites that have existed for many years or may arise in the future. We believe that the members of the Subcommittee will agree that ERISA never intended such a pervasive and inequitable exclusion of the REIT industry, and that the present statutory and regulatory framework unreasonably deprives pension plans and their beneficiaries of access to the benefits of professionally-managed, highly diversified portfolios held by REITs.

II. The Effect of the ERISA Prohibited Transactions and Other Fiduciary Rules in the REIT Context

A REIT trustee functions as a fiduciary responsible to the shareholders of the entity. In some jurisdictions, his or her duties may be essentially indistinguishable from those of a corporate director, while in other jurisdictions local common or statutory law may impose a higher degree of responsibility. In any event, should a REIT trustee be deemed a plan fiduciary by operation of the plan asset rules, the fundamental standards of ERISA section 404 (pertaining to prudent exercise of discretion over plan assets to maximize benefits and minimize costs in the sole interests of plan fiduciaries) would not drastically alter the conduct of REIT operations. Additionally, the prohibited transactions rules of section 406(b) and 407 do not constrain business activity.

What utterly frustrates the placement of REIT securities with pension plans is the inordinately broad section 406(a) prohibition against specified transactions between a REIT (as a plan asset) and certain "parties in interest" that are connected to the plan in the manner described in section 3(14). An active real estate business involving hundreds of transactions annually, the broad list of prohibited transactions, and the confusing and sometimes endless roster of related parties, particularly in the case of multiple-plan investment, combine to render the REIT incapable of entering into virtually any transaction without incurring disabling administrative costs or unacceptable risks.

Furthermore, the section 406(a) prohibition is supplemented by an equally crippling corollary limitation in the ERISA tax provisions. Applicable to the same series of section 406 transactions if they involve "disqualifed persons" (a category equivalent to "parties in interest"), section 2003 of ERISA imposes an excise tax on the related party equal to five percent of the amount of the transaction.

The in terrorem effect of these rules is obvious and intended, for the drafters of ERISA sought to prevent parties in a position to influence plan investment decisions from diverting plan assets for personal gain on or for other abusive purposes. As illustrated in greater detail below, however, the sweeping reach of the prohibited transactions tests results in extraordinary costs of compliance and inappropriate risk of inadvertent breach. The net effect for entities like REITs is not so much the deterrence of undue manipulation by pension plan insiders but rather the creation of an absolute barrier to pension plan investment. This consequence is inequitable, operates to the detriment of both plan beneficiaries and the shareholders of REITs, and could not have been intended.

III. The "Party in Interest" Rules

In focusing on the rules themselves, it is evident that the principal difficulty for a REIT trustee and the plan lies in the breadth of the statutory definition of "party in interest" set forth in section 3(14) of ERISA. In large measure because of the attempt to attribute the tainted relationship to affiliates of parties who in fact deal with a plan, it is conceivable that the list of related parties for a major plan may number in the thousands and be subject to change on a daily basis.

Not only are the employers and unions of each employee covered by the plan included among parties in interest, but also encompassed are the direct or indirect owners of a 50 percent interest or share in those employers or employee organizations. Furthermore, a subsidiary entity in which any employer or employee organization owns at least 50 percent interest becomes a party in interest. Thus, assuming a pension plan sponsored by a major corporation benefits the employees of each affiliate of that corporation, the plan must treat as a party in interest each affiliate, every individual or entity holding a 50 percent interest in the affiliate, and every organization in which the affiliate owns at least a 50 percent interest. To further complicate matters, the tainted relationship attributed to the individual or entity owning the requisite interest in the sponsor's affiliate is reattributed to any other entity in which that individual or entity directly or indirectly owns at least a 50 percent interest.

These constraints represent perhaps a minor aspect of the difficulties, however, because the related parties of a plan also include each employee, officer, director, or similarly situated individual, as well as a ten percent or greater owner of each affiliated entity whether it is in the form of a corporation, partnership, or other association. An even greater complication is that any party providing any form of services to a pension plan becomes a party in interest, together with the employees and major shareholders of that party. Moreover, in the same manner as described above, any affiliate of the servicer, and its own affiliates, may become related parties.

Finally, with respect to each employer of a plan beneficiary, each servicing party, and each of the "tainted" affiliates identified as above, there is additional reattribution of the plan relationship for any partner or joint venturer having at least a direct or indirect ten percent interest in a venture in which a tainted party participates. Taking this and all the other factors into account, it is obvious that a REIT trustee, or any plan fiduciary, must confront a voluminous and fluid roster of related parties. As noted previously, the already nightmarish problems may be compounded beyond measure should several plans invest in a REIT.

IV. The Section 406(a) Prohibited Transactions

The formidable exercise of constantly identifying all related parties to a plan is of course prefatory to the essential function of evaluating each prospective transaction to ascertain whether any party to the transaction is a party in interest. Although the REIT may anticipate that the plan fiduciary will share the initial burden of compiling the list of related parties, the cost and responsibility for investigating the possible plan relationships of parties to REIT business transactions falls squarely upon the REIT trustee himself. In this context, section 406(a) precludes the trustee from activities such as selling, exchanging or leasing any REIT property, borrowing or lending any funds and receiving or providing any goods or services, if a party in interest is a party to the transaction. Such transactions are of course the essence of REIT operations.

A REIT that owns a number of office buildings, apartments or shopping centers may conduct hundreds of leasing transactions in a year. Often, the transactions are negotiated by agents servicing properties dispersed throughout the country. Although the drafters of ERISA suggested that "(i)n the case of a normal, insubstantial day-to-day transaction, it may be sufficient to check the identity of the other party against a roster of parties in interest, "2/ a REIT is placed in an untenable position. Even assuming that some leasing transactions may be characterized as day-to-day or insubstantial, few REIT trustees could operate comfortably given the number of transactions and the fact that the REIT may be compelled to execute them through an agent or independent contractor.

2/ H.R. Rep. No. 93-1280, 93d Cong., 2d Sess. 307 (1974).

The process becomes significantly more burdensome, of course, for a transaction that is not insubstantial, because the REIT trustee may be required to "make a thorough investigation of the other party's relationship to the plan...." 3/ prior to closing the transaction. In such a case, the pension plan list of related parties is apparently of no aid, and the trustee must independently make the kinds of analyses described previously to assure himself of the absence of a tainted relationship with respect to each contracting party.

V. Practical Illustrations of the Incompatibility of REIT Operations and the Prohibited Transactions Rules

To visualize the pervasive impact of the prohibited transactions rules, assume for example that a pension plan obtains the services of the local office of a national accounting firm. A REIT, as a plan asset, may not lease property to nor utilize the services of any other office of that firm. Moreover, no employee of that firm may purchase shares of stock from the REIT. Similar consequences accompany the engagement by a REIT of a major brokerage firm to manage the sale of REIT securities.

Alternatively, consider a REIT that becomes an asset of a plan sponsored by a major manufacturing concern that has an affiliate engaged in the production of certain structural components of buildings. The REIT may conceivably be precluded from purchasing or constructing a building in which the components are or may be installed. If in fact the proposed activity is construction of a building, the review of the parties involved may be a monumental task, given the variety of parties involved such as other equity participants, short and long-term lenders, architects, appraisers, contractors, bricklayers, plumbers and electricians.

A REIT must also take into account that, upon entering into a contract for management of an apartment building or other property, it may not subsequently enter into a second contract with the management company because that company had become a party in interest by virtue of the first contract. Moreover, to view conversely the matter of contracting for services, it is conceivable that some organizations will be reluctant to deal with the REIT for fear that they and their affiliates will be precluded from providing services to the plan itself during the term of the REIT service contract.

These difficulties themselves pale in relation to the burdens and costs that a REIT may encounter in a major transaction such as the transfer of a large office building from or to a widely-held limited partnership. The thorough investigation of each partner and the review of the list of tenants present extraordinary problems, particularly if the REIT transfers or receives the property as a joint venturer with yet another partnership. As in all cases, the problems become insoluble if the REIT has more than one or two

3/ Id.

plan investors. In a highly competitive real estate market where quality real estate may be in great demand, the delays in ascertaining compliance with ERISA may prove fatal. Moreover, if the presence of a party in interest is discovered, the parties to the transaction may lack the flexibility to adjust and the opportunity may be lost forever.

In summary, the REIT industry and pension plans justifiably view the prohibited transactions rules of ERISA as a source of such enormous problems that the purchase of REIT securities by plans is simply not feasible. Although REITs provide an effective flow of capital into real estate with the concomitant benefit to the economy at large through creation of jobs and other opportunities, the prohibited transactions rules effectively impede any investment of pension plan capital. Plan beneficiaries and REIT shareholders are thus deprived of the benefits that would otherwise inure from the prudent investment decision to invest in a REIT because of portfolio diversity and a steady, reliable record of performance.

Significantly, this unfortunate result seems to be totally unfounded given the intent and concerns of ERISA. A REIT may have thousands of shareholders, and indeed must have at least 100 in order to be tax qualified. Moreover, no five or fewer individual shareholders may own more than 50 percent of the outstanding shares during the last half of a REIT taxable year. [4]Generally, at least one class of its securities is registered pursuant to federal and state law and may be traded on a national or major regional exchange. Trustee responsibilities and contracts with real estate investment advisors are specifically addressed in the REIT Statement of Policy adopted by the North American Securities Administrators Association and implemented in some form in virtually every state. We are confident that sufficient checks exist within the REIT itself to prevent abuse of REIT funds and assets that would in turn pose a threat to plan funds invested in the REIT.

VI. The REIT as an Investment Opportunity for Pension Plans

Diversity of portfolio and operations is the hallmark of the REIT industry as a whole as well as the individual trust and corporate entities of which the industry is comprised. Given their specialization in real estate, many of these diversified REITs should and do have particular appeal to pension plan fiduciaries who have recognized the advisability of expanded real estate holdings and who must satisfy their obligations to diversify plan assets and maintain liquidity. Furthermore, the REIT industry has over recent years compiled an excellent record of steadily increasing yields to its shareholders.

[4] Int. Rev. Code §§542 and 856(a)(5),(6).

The investment appeal of the industry derives in large part from the special tax status accorded REITs in sections 856 through 860 of the Internal Revenue Code ("Code"). Provided they maintain a high degree of specialization in real estate and distribute virtually all of their earnings to shareholders, REITs are exempt from federal income taxes on such distributions. This advantage is obtained through strict compliance with operating requirements imposed by the Code, extending to complete prohibition of development of properties for sale.

This prohibition against trading in properties constitutes the single major categorical limitation of real estate activities available to REITs. For example, while many REITs prefer to engage in the financing of real estate development through mechanisms such as land purchase-leasebacks or long-term mortgages, others may favor outright ownership or joint ventures. REITs routinely tailor their investment arrangements to provide a high level of present or potential participation in the income and equity of properties, thus affording themselves a hedge against inflation. REITs provide substantial funds for investment in income-producing properties such as apartments, office buildings, shopping centers, industrial properties, hotels and motor inns. Many large REITs may in fact have investments in every form described above. In contrast, other REITs may specialize in holding a number of interests falling in only one or two of these categories, relying on their expertise in managing the particular form of investment and factors such as geographic dispersion to minimize risk and ensure a steady return.

Irrespective of the form its portfolio may take, a REIT plays an active, involved role in the development and operation of properties in which it has an interest. Although originally limited to a more passive role, REITs have, through experience and amendment of the tax laws, developed the capability and commitment to participate in all aspects of selecting and operating quality real estate.

For example, a REIT engaged in the development of properties for rent may, in the ordinary course of business, perform activities such as:

- selection and site procurement
- site planning and development, architect, contractor and design selection and feasibility review
- contracting for construction of or improvements on rental housing, commercial or industrial buildings or shopping centers
- price (rental) determination and negotiation with prospective tenants as to the terms and conditions of space leases
- the establishment of policies related to maintenance, insurance, repairs and capital improvements
- financing and refinancing

With regard to REITs whose portfolios include mortgage investments, the provision of financial services include:

- the operational functions of credit evaluation
- the economic analysis of the feasibility and viability of the real estate which is the subject of the mortgage (including long-term prospects and the economic status of the surrounding area)
- the monitoring of construction progress, expenditures and quality
- the work-out of problem loans, institution of foreclosure procedures
- the management of foreclosure property

Against this backdrop, the REIT industry provides prudent, rewarding investment opportunities for pension plans. A number of plans have long recognized the value of REIT investments. For example, one major REIT has determined that pension plans acquired direct or indirect ownership of approximately 65 percent of its outstanding common stock in the years prior to issuance of the proposed "plan asset" regulations. Moreover, while REITs and present or prospective pension plan investors await clarification of the uncertain application of the ERISA fiduciary responsibility rules, unrestrained foreign pension plans evidence their favorable assessment of REIT investments by expanding their interests in a number of REITs.

VII. Proposals for Change

The drafters of S.1541, the Retirement Income Incentives and Administrative Simplification Act of 1981 (Act), have acknowledged the overbreadth of the prohibited transactions rules by proposing that the rules apply generally to transactions unsupported by the exchange of adequate consideration. This proposal thus represents a return to somewhat the same framework existing prior to enactment of ERISA. Additionally, the drafters would mitigate the restraints with respect to the separate accounts of insurance companies and the commingled funds of banks by exempting such pools from treatment as plan assets for purposes of the prohibited transactions rules. The corresponding barriers presented by the adverse tax incidents of prohibited transactions would in turn be eased by the limitations on the enforcement responsibilities proposed in Title IV of the Act.

While applauding these proposals as demonstrating increased sensitivity to the problems caused by the prohibited transactions rules, the REIT industry finds the scope of the proposed relief to be too narrow. In a case such as that of REITs, where pension plans are effectively but unnecessarily excluded from investing in an entire industry, we believe that the drafting of specific relief is warranted. The diversity of the industry, the multiplicity of potential REIT real estate transactions, the prevalence of multiple-plan investment through group trusts, the negligible threat of abuse of plan funds by REITs, and the clumsiness of the administrative process for exemptions from the prohibited transactions constraints all serve to justify a statutory framework in which pension plans may assess the investment opportunities of REITs without the unwarranted limitations imposed by present law. Accordingly, NAREIT urges the Congress to extend to REITs a statutory exemption similar to that proposed in section 3511 of the Act for the pooled funds of banks and insurance companies.

At the same time, we recognize that alternative means may be available to afford relief to the industry and any others similarly situated. We strongly support any efforts to facilitate pension plan investment in the real estate industry in general and to ease the unduly pervasive effect of the prohibited transactions rules. In conclusion, we urge the Subcommittee and the Congress to examine closely the constraints imposed by present law, and in the process, to consider amendments that will permit pension plans to acquire freely the securities in REITs that offer prudent, rewarding investment opportunities.

As an industry, we support and endorse the efforts of the Subcommittee and I would personally welcome any opportunity to be of service in that endeavor.

Sincerely,

Allan H. Glidden
President, NAREIT

/thw

STATEMENT ON BEHALF OF THE ASSOCIATION OF ADVANCED LIFE UNDERWRITING AND THE NATIONAL ASSOCIATION FOR LIFE UNDERWRITERS SUBMITTED TO THE SUBCOMMITTEE ON LABOR OF SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES ON S.1541

The Association for Advanced Life Underwriting (AALU) is encouraged that active Congressional consideration is being given to revisions in the Employee Retirement Income Security Act of 1974 (ERISA). ERISA, although only seven years old, is in need of substantial revision; S.1541, the Retirement Income Incentive and Administrative Simplification Act of 1981, is a major step in that direction. We are submitting this written statement to aid the subcommittee in its deliberations on this important bill.

AALU is a nationwide organization of approximately 1,100 members specializing in one or more fields of advance life underwriting. Collectively our members are resposible for annual sales of life insurance in excess of $2 billion, mostly in circumstances involving complex factual situations and often dealing with qualified retirement plans and similar employee compensation techniques. Much of the work performed by our members is with relatively small businesses.

The National Association of Life Underwriters (NALU), which has a membership of 1,022 state and local associations with a combined individual membership of over 130,000 life insurance agents, general agents and managers, joins AALU in the submission of this statement.

GENERAL COMMENTS

Although there is widespread agreement that ERISA has unnecessarily increased the administrative burdens on employers and plan administators, there is a great diversity of opinion about the types of reforms that should be implemented. Central to this problem is the recognition that ERISA performed a necessary function in increasing the regulatory oversight of the pension field. Finding the delicate balance between minimizing burdensome administative requirements and maintaining appropriate regulatory oversight is always difficult.

One of the fundamental problems that has lead to the unnecessary administrative burden is the multi-jurisdictional aspects of ERISA. While numerous governmental efforts have been made to minimize this problem, plan administators are still faced with regulation by three major agencies (the Internal Revenue Service, the Labor Department and the Pension Benefit Guaranty Corporation) and, to a lesser extent, other government offices. Unless substantial effort is made to resolve this problem, meaningful overall ERISA reform will not be possible.

The reporting and disclosure requirements of ERISA represents another example of the unnecessary oversight that ERISA created. Many of these requirements, which result in substantial employer costs, do not result in the conveyance of any useful information to either the government or plan participants. Reporting and disclosure reform are especially needed.

We will here address only those proposed S.1541 reforms which we consider of major importance. We will not attempt to comment on every aspect of this bill.

SPECIFIC RECOMMENDATIONS

1. Reporting and Disclosure

Subtitle B of Title III of S.1541 contains numerous important revisions to the reporting and disclosure requirements of ERISA.

a. Summary Plan Description

Section 3206 of S.1541 would require that summary plan descriptions be updated every 10 years instead of every five years. We strongly support that change.

AALU recommends that S.1541 be additionally modified to lessen further this disclosure requirement. There does not appear to be any necessity to provide participants and beneficiaries with entirely new summary plan descriptions when they have previously received such descriptions that are essentially accurate. We believe that the plan administrator should simply be required to make a copy of the current summary plan description, including all modifications, available for inspection during reasonable business hours. All participants should receive a copy an initial summary plan description plus any modifications to that summary plan description. In this way participants and beneficiaries would receive directly all the information they need. Plan administrators should also be free to update summary plan descriptions at any time that a revised summary plan description is appropriate. This change would elininate the unnecessary burden of requiring new summary plan descriptions to be provided in accordance with a fixed period of time, even though the participants may still have adequate information regarding the plan.

In addition, the requirement that summary plan descriptions be submitted to the Department of Labor should be eliminated. Such submissions have proved costly, burdensom, and largely ineffective. Based on AALU's experience, the summary plan descriptions on file are of limited availability and little use.

b. Summary Annual Reports

Section 3205 and 3207 of S.1541 would substantially ease the disclosure requirement imposed by ERISA with respect to summary annual reports. We endorse such changes, especially the proposed deletion of the requirement that summary annual reports must be distributed to participants.

AALU's experience has been that most plan participants are not interested in the financial information provided by the summary annual reports since they repeatedly receive benefit statements that provide them with detailed information regarding their particular benefit rights under the plan. Further, many plan participants are confused by the financial information contained in the summary annual report.

c. Annual Reports

One of the most burdensome of the reporting requirements presently in existence is the annual reporting requirement. Although the form 5500 series now combines the annual report to the Labor Department and the Internal Revenue Service on a single form, further simplification is necessary. The information required for the form 5500 series is very detailed and requires extensive record keeping and analysis.

The new triennial reporting system requirements do not satisfactorily alleviate the reporting burdens; they exacerbate them by requiring more detailed information to be filed every third year. As a consequence, plan administrators must keep the same amount of information available but are simply excused from filing the report in two out of the three years.

In addition, defined benefit plans are required to file a separate report with the Pension Benefit Guaranty Corporation and to pay premiums to that agency. The overlapping jurisdiction problem could be minimized if the annual reporting and premium requirements to the Pension Benefit Guaranty Corporation were handled through the annual report filed with the Internal Revenue Service. In this way a single report would be required from all plan administrators on an annual basis. Premiums required by the Pension Benefit Guaranty Corporation could be collected by the Internal Revenue Service for forwarding to its ultimate destination.

Of particular importance to the insurance industry is the requirement that Schedule A, regarding insurance commission information, be filed with the annual report. An alternative method is available for providing substantially the same information as is currently required by Schedule A without imposing the burden of additional recordkeeping and computation. Under Prohibited Transaction Exemption No. 77-9, which permits insurance agents to sell insurance products to pension plans in most cases, agents are required to provide detailed information regarding compensation earned on sales of insurance products to plans. The same information could be attached to the annual report in lieu of completing the detailed commission information now required on Schedule A. This information, which is deemed adequate to protect plan fiduciaries for purposes of the prohibited transaction rules of ERISA, should also be adequate for Schedule A purposes. This would substantially minimize the burden imposed on insurance agents and their companies, while equally protecting the rights of participants and beneficiaries.

d. Termination Reports

Currently, termination of defined benefit plans require approval from two separate agencies, the Internal Revenue Service and the Pension Benefit Guaranty Corporation. This two agency approval process can cause delays of well in excess of a year.

A unified termination procedure should be developed so that a single termination report may be filed with either the Internal Revenue Service or the Pension Benefit Guaranty Corporation. Approval by the single agency would operate automatically as approval by the other agency. Presently both agencies have separate rules regarding plan asset allocation and termination and it may be necessary to revise the statutory rules regarding asset allocation to facilitate the ability of plans to file a single termination report.

2. Safe Harbor Vesting

Section 4810 of S.1541 provides safe harbor vesting rules which are among the most important provisions of S.1541. We strongly support adoption of this section.

The need to adopt statutory rules on safe habor vesting arose because of a change in policy by the Internal Revenue Service and the Treasury Department. Shortly following the enactment of ERISA the Internal Revenue Service and the Treasury Department promulgated rules that led plans, especially smaller plans, to adopt so-called 4-40 vesting schedules, which were generally understood to be safe harbors. In 1980, however, the Internal Revenue Service and the Treasury Department issued proposed regulations that would eliminate this safety net, notwithstanding meaningful taxpayer reliance. AALU further understands that the Treasury Department and the Internal Revenue Service are still disposed to finalize these regulations. Consequently, there is an important need for substantive legislation that would return the situation to the status quo that existed before the change in Revenue Service and Treasury Department policy.

3. Funding Future Benefit Changes

Sections 3403 and 4403 of the bill would rightfully permit employers to fund reasonably anticipated future increases in benefits. The Internal Revenue Service will currently not permit funding of reasonably anticipated benefit increases until the year in which the benefit increase becomes effective. This has the inherently detrimental effect of undermining adequate plan funding by ignoring inevitable facts such as inflation. The change suggested by the bill is entirely appropriate and should be adopted.

4. Changes in Actuarial Assumptions

Sections 3306 and 4306 of the bill permit plans to change the actuarial assumptions used to compute actuarial equivalence of optional forms of benefits so long as the actuarial assumptions are set forth in a separte document available to plan participants.

AALU supports this statutory change as an appropriate method of resolving a recent dilemma created by the Internal Revenue Service when it took the position that changes in the actuarial assumptions, which are used to compute benefit option equivalence, could reduce participants' accrued benefit in violation of ERISA. This recent change in long-standing Service position has added substantial complexity to the operation and administration of plans. The Service has admittedly promulgated procedures under which the plans can use variable actuarial assumptions in determining benefit equivalence; however, appropriate selection of the actuarial assumptions requires a complex analysis which is difficult to employ. The high volatility of interest rates in recent years has demonstrated the importance of flexible actuarial standards. The Internal Revenue Service's position is a substantial burden to plan administrators and should be rejected.

5. Joint and Survivor Annuities

Sections 3309 and 4309 of the bill would substantially revise the joint and survivor annuity requirements of ERISA. The changes are particularly welcome since these requirements are among the most complex aspects of ERISA and have caused some of the greatest operational difficulties for plans.

In particular, we support the provisions in S.1541 that would permit defined contribution plans to offer annuity options without requiring compliance with the joint and survivor annuity requirements. The practical impact of the Internal Revenue Service interpretation of ERISA in this regard has been to eliminate all annuity options from most defined contribution plans. Consequently, this proposed change is to the benefit of plan participants since it would have the practical affect of making an additional option available to them.

AALU also supports the provisions of S.1541 that would permit early survivor annuities to be paid in a lump sum without requiring elaborate election procedures. Again, simplification and the elimination of unnecessary procedures is the primary motive.

6. Changes in Funding Method

Sections 3402 and 4402 of the bill would permit a limited number of changes in the funding method used by the defined benefit plans, without requiring advance Treasury Department approval for such changes. Under the bill a change may be made once during any three year period without approval.

AALU supports this provision as adding important flexibility to plan operation without substantially jeopardizing employee benefits.

7. Prohibited Transaction Changes

Section 3505 of the bill would revise the prohibited transaction rules of ERISA so that prohibited transactions would only involve transactions between a plan and a party in interest for less than adequate consideration.

We support these changes as removing a substantial artificial impediment to the proper operation of employee benefit plans. The general ERISA prohibition which forbids all dealings between plans and parties in interest, has proven overly broad and administratively cumbersome. Many responsible groups have been forced to obtain administrative exemptions such as Prohibited Transaction Exemption No. 77-9. Obtaining such class exemptions is not only expensive, but during the one to three year approval period, plan dealings are placed in jeopardy.

Although the approach taken in S.1541 eliminates for the most part the general restrictions on dealings between plans and parties in interest, unnecessary and unworkable burdens remain. For example, for a permissible sale to occur between a plan and a party in interest, it is necessary that there be adequate consideration. In many cases, it will be difficult to determine precisely the fair market value of property. The parties involved in such a transaction will be in considerable jeopardy that the Labor Department or the Internal Revenue Service will, with hindsight, determine that the price, no matter how carefully determined in advance by the parties, does not reflect fair market value. S.1541 should, therefore, be modified to eliminate all the prohibited transaction provisions of ERISA. They should not merely be reduced to an arm's-length standard. Adequate safeguards would still exist through the requirements that plans operate in the exclusive interest of participants and beneficiaries and that fiduciaries must comply with the ERISA prudent man rules.

8. Single Entry Dates

Section 3301 and 4301 of the Bill would permit plans to utilize single rather than dual entry dates. Consequently, plan participants would be permitted to begin participation on a single day during the plan year rather than be required to begin at one of two entry points during the plan year.

AALU supports this long overdue change. Dual entry dates require unnecessary administration and paperwork. For insured plans this extra paperwork can be especially difficult because it requires the issuance of separate insurance policies at the second entry date.

9. Alimony

Sections 3310 and 4310 would provide needed clarification to the rules regarding payment of alimony and marital support from plan assets. The multitude of conflicting court cases on this subject requires that Congress settle the problem. Plan administrators should have clear guidance on how to operate when approached for alimony or child support payments. The diversity of court opinions has created an administrative nightmare.

The approach taken in S.1541, although it prohibits benefits from being paid out at any time earlier than they otherwise would be under the provisions of the plan, wisely recognizes the right of former spouses and children to receive benefit payments.

10. Single Agency

As noted in our general comments, multi-agency jurisdiction is one of the core problems inherent in the original ERISA legislation. Title I of S.1541 would attempt to solve this problem by the creation of a new agency, the Employee Benefit Administration.

We are sympathetic to the motivations underlying the single agency recommendation. However, the proposals in S.1541 regarding the creation of such an agency would create more problems than they would solve. The tax questions involved in many of the employee plan matters cannot properly be divided between the Internal Revenue Service and the Employee Benefit Administration. Further, a vast restructuring of the administrative agencies at this time would create immense new problems and it is questionable whether the resulting product would be substantially more efficient.

We recommend an approach that leaves existing agencies in place and improves coordination among them. For example, eliminating duplicate, multiple reporting and disclosure requirements by mandating filings with a single agency would substantially eliminate the principal problem that plan administrators and employers face under the multiple jurisdiction structure.

11. Integration Rules

Section 4811 of S.1541 would provide new integration rules for qualified retirement plans. We understand these provisions are designed to simplify the integration rules currently in existence. We note, however, that the new integration rules proposed in S.1541 are, in themselves, very complex and difficult to understand.

AALU is opposed to any change in the existing rules on integration. Changes in those rules would be detrimental and unnecessary. They would entail costly plan document amendments and serious disruption in the operation of existing plans, especially those of smaller companies, many of which are already integrated with social security. The disruptive effect created by requiring changes in the integration rules would create further incentives to plan terminations, thereby reducing the retirement coverage of employees.

The existing rules, although complicated, are generally well understood by those who administer the rules. Plans in general rely on expert assistance from actuaries, consultants, insurance companies or other advisers in the maintenance of a properly integrated plan. Those technicians are able to comprehend the existing rules with little difficulty, especially since these rules have been in place for a long time. The apparent complexity in the existing integration rules is only superficial. Those who need to understand the rules, in fact do.

12. Payroll IRA

Title V of the Bill would create a payroll individual retirement account plan for employees that are not covered by pension plans. We recognize the laudatory goals of this provision, but nevertheless recommend that it should not be included in any legislation. The administrative burdens outweigh the benefits.

Small employers would be forced to develop or hire sufficient expertise on this issue to assure that they have complied with the new requirements which would be expensive to administer and would literally force the employer to provide a retirement program for employees. Employers should not be so required to so act, particularly in view of the fact that employees have the freedom to contribute up to $2,000 on a tax deductible basis to an individual retirement account.

13. Plan Termination

Title VI of the Bill would provide plan termination rules for single employer plans that are comparable to those enacted for multiemployer plans in the Multiemployer Pension Plan Amendments Act of 1980.

The principal impetus to the modification of the plan termination rules has been from larger employers. A difference in view exists among smaller employers. The financial burdens for smaller employers would be substantially increased under the proposals of Title VI. If enacted, the provisions of Title VI will essentially force smaller employers out of defined benefit plans as a means of avoiding the contingent financial liability that would be created.

AALU, therefore, strongly opposes the enactment of Title VI of S.1541. Unless substantial revisions can be made that would protect smaller employers and permit stockholders of small businesses to retire without fear of their own retirements being jeopardized by plan termination, Title VI should be abandoned altogether. While there are substantial problems with the present plan termination provisions of ERISA, the changes proposed in S.1541 exacerbate rather than relieve the problem for smaller employers.

STATEMENT OF ASSOCIATED BUILDERS AND CONTRACTORS

Associated Builders and Contractors (ABC) is a national construction trade association representing over 16,000 firms nationwide. The members of ABC believe in the "merit shop" philosophy of awarding construction contracts to the lowest responsible bidder. Today, more than 60 percent of all construction is done the merit (open) shop way.

ABC supports the efforts in the Employee Retirement Income Security Act of 1974 (ERISA) to establish basic rights for participants and beneficiaries and minimum standards for pension plans. However, the passage of ERISA created a dramatic increase in the administrative costs of private plans, a significant reduction in plan design flexibility, and expensive delays due to its cumbersome regulatory processes. ABC believes that the goals of ERISA can be met while at the same time eliminating unnecessary paperwork and other burdens.

S. 1541, THE "RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE SIMPLIFICATION ACT OF 1981"

ABC believes that S. 1541, the "Retirement Income Incentives and Administrative Simplification Act of 1981" provides a firm foundation for the development of appropriate remedies for overregulation under ERISA. And ABC endorses the stated purpose of S. 1541 which is "to consolidate and simplify the administration of the provisions of law relating to retirement income arrangements, [and] to provide for incentives for pension plan coverage and increased retirement savings."

Title I - Employee Benefit Administration

ABC strongly supports Title I of S. 1541 which establishes a single agency to regulate employee pension and welfare benefit plans. Inadequate coordination among the Departments of Labor (DOL), the Internal Revenue Service (IRS), and the Pension Benefit Guaranty Corporation (PBGC) has placed an excessive paperwork burden on pension plans. The agencies have wasted millions of dollars because of duplicative procedures. ABC believes that the creation of a single agency to administer ERISA is the most important key to simplification of the Act. A single agency would provide more efficient administration of the law, reduce government costs, and result in unified policy making.

Title II - Deduction for Contributions to Retirement Plans

ABC also supports the provisions of Title II of S. 1541 which would allow employees to take tax deductions for mandatory as well as voluntary contributions to employer plans. The bill equalizes the tax treatment of retirement contributions by employees thus providing an inducement for additional retirement savings.

Title III - ERISA Corrections, Clarification, and Simplification

ABC strongly endorses the provisions in Title III of S. 1541. Proposed changes in reporting and disclosure, participation and vesting, funding, fiduciary requirements, and other areas would substantially ease the burdens of plan administration without operating to the detriment of plan participants and beneficiaries.

ABC particularly supports the simplified reporting and disclosure proposals in Title III. The government currently requires so much information that it cannot use any of it quickly or effectively. However, ABC believes there can and should be even more comprehensive changes in the reporting and disclosure requirements, including:

- abbreviation of the ERISA annual report form;
- elimination of the summary annual report requirement;
- allowing plans to distribute ERISA material by posting rather than mailing;

ABC is also concerned about the provision in Title III of S. 1541 that would change the prohibited transactions provisions by allowing such transactions if the plan receives the same amount of money it would if it were dealing with a party that had absolutely no relationship to the plan. While we agree that the prohibited transactions provisions of ERISA are too extensive, we believe that any change in these provisions must be carefully crafted to insure that it does not create any additional danger to plan assets. ABC believes, for example, that it is difficult, if not impossible, for fiduciaries to maintain an appropriate arms-length relationship with a plan's controlling influence.

Already, there is evidence that union pension trust fund trustees influence financial institutions in a way that could potentially destroy the safeguards that should surround an independent fiduciary. For example, the Prudential Life Insurance Company and Aetna Life and Casualty Company have, with Department of Labor approval, established separate accounts for union investments. The funds in these separate accounts are invested in mortgage loans or real properties developed or improved with union labor only. In addition, the AFL-CIO recently announced a plan to launch a new investment trust using union pension and benefit funds. This investment trust will loan money to developers of rental and single-family housing that is exclusively union built.

ABC believes that such discriminatory investment policies are potentially harmful to both pension plan beneficiaries and the construction industry. Banning investments in certain areas - in this case the 60 percent of construction in the United States that is done open shop - could affect optimum fund performance. Taking non-financial factors into account is highly subjective and would make common standards for evaluating investment performance nearly impossible. If the pension fund does not perform up to expectations because of such investments, who will make up the deficiency - the beneficiary, the trustees, or the government?

Nearly two-thirds of the pension fund assets in this country involve union monies. All but a fraction of these funds are handled by major financial institutions. Because of the size of these investments, it may be possible for union pension trustees to use their influence with these financial institutions to create more jobs for union members at the expense of plan beneficiaries and the nearly three million construction workers in the United States who have chosen not to join unions.

Thus, ABC strongly urges that Congress amend ERISA to include a prohibition against transactions that discriminate in any fashion against any person because of his affiliation with or lack of affiliation with a labor organization. We further urge that Congress amend ERISA to create a private right of action for individuals who have been discriminated against because of their affiliation with or lack of affiliation with a labor organization.

Among the provisions of Title III that ABC supports are those that would:

-- exempt certain severance pay and supplemental retirement income arrangements from the provisions of ERISA;

-- require accountants and actuaries to rely on each others' opinions;
-- permit the eligibility for plan entry to be counted on a plan year basis;
-- revise the joint and survivor annuity requirements by (1) allowing plans to provide a non-annuity-type payment as the automatic benefit form; (2) relieving certain plans of the requirement that they establish early survivor annuity election requirements; and (3) permitting plans to allow participants to choose a survivor other than their spouse;
-- permit actuaries to make funding recommendations based on future benefit changes;
-- clarify ERISA's preemption provisions;
-- clarify that a named fiduciary to whom a specific duty has not been allocated will not be held liable for an act or omission with respect to that duty by the named fiduciary to whom that duty has been allocated;
-- extend the administrative exemption procedure relating to prohibited transactions to persons who are "owner-employees";
-- provide a statutory class exemption for loans and leases made by a defined contribution plan to the major employers establishing and maintaining the plan.

Title IV - Internal Revenue Code Amendments

In Title IV of S. 1541, ABC particularly supports those provisions that would:

-- clarify that employee participation in predecessor plans or other plans of related employers is to be counted toward the eligibility requirements for lump sum distribution treatment;

- clarify the term "separation from the service" for purposes of multi-employer plans;
- allow lump sum employee contributions to be rolled over into an individual retirement account (IRA) and to be rolled over from an IRA back into a qualified pension plan;
- make 4-40 vesting a safe harbor to a discrimination challenge;

Title V - Individual Retirement Payroll Deduction Arrangements for Employees Not Covered by Pension Plans

ABC believes that the provisions in Title V of S. 1541 that would compel employers to provide payroll deduction programs for individual retirement savings for employees not covered by qualified plans is, at best, premature. At worst, this provision is a case of severe overregulation.

Title VI - Single-Employer Termination Insurance Amendments

Finally, ABC supports the concept embodied in Title VI of S. 1541, that is it is desirable:

(1) to modify the current funding and termination insurance provisions relating to single-employer pension plans in order to increase the likelihood of protecting plan participants against the loss of non-forfeitable benefits; and

(2) to modify the termination insurance programs for single-employer pension plans by changing the insurable event from the time of plan termination to the time of the liquidation of the plan sponsor in order to place primary emphasis on plan continuation and contain program costs within reasonable limits.

However, ABC urges that the provisions of Title VI be reviewed and, where necessary, recrafted, in order to completely avoid the difficulties created by the 1980 amendments to ERISA.

S. 1678, AMENDMENT TO ERISA

The demand for housing that is expected to occur in the 1980's will require an enormous amount of capital. Mortgage investments must be attractive to those who make long-term capital investments, such as pension trustees and managers, if this capital is to be raised. ERISA creates a number of unnecessary barriers to mortgage investment.

ABC supports efforts to eliminate these barriers through administrative and legislative changes so that it is possible and practical for private pension funds to invest in residential mortgages. However, ABC is very concerned about the fiduciary aspects of current proposals to eliminate these barriers.

For example, S. 1678 would allow private pension plans to invest in residential mortgages that provide a "reasonable rate of interest." The reasonable rate of interest is defined, in the bill, to be the rate of interest that equals or exceeds the average net yield to the plan for the preceding ten years (or any consecutive three years within such ten-year period) or is reasonable in light of the investment circumstances at the time. This approach seems appealing when interest rates are rising; however, if interest rates were to drop over a period of several years, it could lead to unwise investments. In addition, as applied to the fiduciary duties test, the "reasonable rate of interest" provision in S. 1678 could allow investments in mortgages at rates that met the statutory average net yield requirement, but which would otherwise violate prudent investment standards.

SUMMARY

ABC supports the efforts under ERISA to protect the rights of pension plan participants and beneficiaries and to establish minimum standards for pension plans. However, we believe that the goals of ERISA can be met while eliminating many of the unnecessary burdens created for plan sponsors and administrators by the Act. ABC believes that S. 1541 provides a firm foundation for the development of appropriate remedies for overregulation under ERISA.

We believe that, through the efforts of Congress, the Administration, and groups like ABC, final proposals can be developed that will make ERISA less burdensome while continuing to serve its basic purpose of protecting and insuring the rights of participants and beneficiaries.

JOHN G.
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February 4, 1982

FEB 8 1982

Rick Lawson
Senate Labor Committee
Room 4230
Dirksen Building
Washington, D. C. 20515

Re: S. 1541-RETIREMENT INCOME INCENTIVES AND ADMINISTRATIVE SIMPLIFICATION ACT

Dear Mr. Lawson:

A hearing on the above Bill was held before the Labor Subcommittee on January 26, 1982. I am in favor of that legislation and the reasons and justification for my support are explained in the enclosed statement.

I recommend and request that you also support this Bill.

Enclosed for the record are my comments in support of the above Bill.

Yours very truly,

J G Mutschler

John G. Mutschler
John G. Mutschler & Associates, Inc.

JGM/ju
Enclosure

STATEMENT BY JOHN G. MUTSCHLER
PRESIDENT OF JOHN G. MUTSCHLER AND
ASSOCIATES, INC.

I. BACKGROUND

I would like to comment on some of the provisions in ERISA which I feel are unwise and which I would like to have changed. The pending bill does include those changes and, therefore, I am supporting that legislation.

First, however, I would like to give you some information about my background and business experience. I was graduated from the University of North Dakota in 1950 with a major in accounting and economics. I passed the North Dakota CPA exam in 1950 and also graduated from the University of North Dakota Law School in 1953. I am currently licensed to practice law in both Minnesota and North Dakota.

In 1958 after completing my service commitment in the Air Force and working for two years as an attorney for a company which specialized in designing and administering pension and profit sharing plans, I started my own company (John G. Mutschler & Associates, Inc.) to design and administer pension and profit sharing plans. My company currently has 13 employees and we handle approximately 350 plans for 200 small corporations. Our clients in general are smaller, privately-owned businesses located in Minnesota, Wisconsin, Iowa, North and South Dakota and several other states. Of the plans we administer, approximately 225 are defined contribution plans and 125 are defined benefit plans. I estimate the total assets of the plan trusts to be something in excess of $100,000,000. and annul contributions to the plans are over $9,000,0000. These plans cover approximately 4,000 employees, the average equity of each employee is more than $25,000, and the average annual contribution for each covered employee is about $2,200.

Most of our clients are small, privately and closely-held corporations which can be classified as "small businesses", that is, they typically are owned by fewer than five stockholders, often the ownership is confined to members of one family, and generally there are fewer than 25 employees. It is my understanding that 97% of all businesses are "small businesses" like our clients. In addition, the latest statistics which I have read show that 93% of all retirement plans involve employees of such small privately-owned businesses. Because of this, the impact of ERISA is greater on these small businesses and their employees. Unfortunately that impact is often harmful both to the businesses and to their employees.

My principal reason for appearing before you is to briefly comment on that negative impact caused by certain ERISA rules.

II. BENEFITS OF PRE-ERISA LAW

My and my clients' main criticism of ERISA is that it seriously impairs investments which would contribute to capital formation by smaller businesses. It does that by prohibiting the use of employee trust funds for investments which involve the employer's business.

Prior to ERISA, transactions involving pension and profit sharing trust funds were subject to Section 503(b) of the 1954 Internal Revenue Code. This section, which was consistent with the general common law of trusts, limited transactions between employers and their employee trusts to those commonly characterized as "arms length transactions". Under this law, loans of employee trust funds had to be adequately secured and had to earn a reasonable rate of interest. Fair and adequate consideration had to be paid for property purchased or leased from a trust, and the trust could not pay more than fair and adequate consideration for property purchased by the trust or for services provided to the trust. This law protected the employees' pension interests, yet provided investment opportunities which are so important to small privately-owned businesses and to local communities. In other words, a secured trust transaction with the employer gave a "double benefit", a benefit for employees through higher company contributions, higher trust earnings, more and higher paying jobs, and a benefit for the company by having funds for growth.

Section 406 of ERISA, however, defines a prohibited transaction in such a way as to eliminate any type of transaction between an employer and his pension or profit sharing plan's assets. For example, those two parties may not together engage in any type of sale, lease or loan, even if the terms provide security and a higher rate of return for the trust than can be obtained in convential investments. (For example, if most of my clients paid the going rate of interest at a bank, the trust would earn a return of about 16% to 17%, whereas C. D.s and money markets produce a return of about 12% to 13%. I believe that the prohibitions in Section 406 are unfair and harmful to both the employer and the plan participants.

My clients' experience prior to ERISA proved that certain uses of employee trust funds which are now prohibited were very worthwhile to employees as well as to their employers. We feel Congress may not have fully understood the critical role that such investments played, not only in fostering the establishment and continuation of pension and profit sharing plans for the benefit of employees, but also in contributing to the success of the smaller privately-owned business by making investment funds available to it.

III. ERISA LIMITS CAPITAL FORMATION

The success of any business depends heavily on its ability to accumulate the capital it needs for current operating expenses and for growth and modernization. A typical large business accumulates capital by selling bonds and shares of corporate stock to the investing public. Generally, these methods are not available to the smaller privately owned businesses where basically capital formation must of necessity come out of income and equity from owner-stockholders. Pre-ERISA law provided the Employer with additional funds needed for growth because funds in its profit sharing and pension trusts could be used for fully secured loans at the "going rate of interest" back to the business or could be used for purchasing land, buildings or equipment which in turn could be leased to the business on an "arms length basis". By being able to benefit from such profit sharing and pension assets, the employer was encouraged to make maximum contributions to its pension and profit sharing plans. Employees benefited from those larger contributions and also from the high rate of return on the secure trust investments with the employer. Thus both employer and employee benefited from the Pre-ERISA law. Many of my clients considered these to be "double benefits" because both the company and the employee benefited.

ERISA eliminated all such transactions even if they were based on arm's length negotiations or were in the employees' best interests. The result is that a source of locally generated funds for small corporations has been eliminated. Such operating funds are vitally necessary for the continued success and growth of small businesses, especially during times of inflation and tight money. Small businesses normally have limited access to funds for financing their expansion (generally local banks and loans and equity from stockholder-owners are the only source of capital, when available.) The post-ERISA inability of small companies to borrow trust funds on a secured basis from their retirement plans is extremely detrimental, especially during this current period of inflation and increased competition for money (as evidenced by historically unprecedented high interest rates). This change in law also discouraged formation of countless new plans. Prior to ERISA my firm installed 20 to 30 new plans a year with 90% being for small contractors, stores, etc. Post-ERISA, 90% of our new plans are for professional people and only 10% for small businesses.

Employers' inability to deal with their trusts has caused many trustees of retirement plans to invest their trust assets in large, Fortune 500 companies. In that way, national firms (e. g. GMC, K-Mart, McDonald's, Daytons, etc.) obtain capital and are able to expand and better compete with small business in the latters' trade area. Thus there is a double detriment to small business: not only is a source of operating capital removed, but that same locally generated capital often is used by large competitors to drive the local company out of business.

IV. PRUDENT MAN RULE

ERISA not only prohibited transactions with the employer but it also restricted the other types of investments which a trustee can make. It did that by imposing a federal "prudent man" rule. Fiduciaries are now required to perform their duties with a very high degree of care and skill. The federal rule appears to impose a much higher standard for managing investments than does the "reasonably prudent investor" standard under most state rules. The existing "prudence" standard requires a fiduciary to diversify the investments of the plan so that the risk of large losses will be minimized.

Both the prohibited transaction rule and the prudent man rule have had numerous detrimental effects.

V. IMPACT ON LOCAL ECONOMIES

The fiduciary duties outlined in ERISA and the new prohibited transaction laws have forced prudent fiduciaries of pension trusts to invest plan assets in only the most supposedly secure type of investments, namely highly rated bonds and blue chip securities of large public corporations (Fortune 500 Companies). In other words, trustees of pension trusts must be ultra-conservative. They must be defensive. They cannot afford to take the risk of investing in any sort of venture capital company or in an enterprise that can be considered as having any risk. If they are wrong, they can be sued and held liable for any losses; their organization can be sued. The result is that locally generated cash flows out of the local economies of Wisconsin, Minnesota, North Dakota, South Dakota, Montana, Wyoming, and other states located outside financial centers into the large finanical centers like New York, Chicago, etc. No longer can pension assets be invested locally where they stimulate and strengthen the local economy. When capital accumulated in a local community is removed from that community and invested elsewhere, the entire community suffers from the loss of local investment and the resulting decline in local jobs, local business opportunities, local productivity, and local services and markets. Prior to ERISA, pension and profit sharing plans helped prevent this removal of investment capital from local communities because the capital accumulated in the plans of small locally-owned businesses was readily available for secure and safe investment back into these same local businesses. This can easily be verified by examining the investments of any local bank trust department. I assure you that you will not find any investments in local small business. I have served on the investment boards for pension and profit sharing plan funds. All trust funds came from local small businesses but not one, I repeat not one, investment was in a local business.

ERISA investment requirements result in locally generated capital moving out of local areas where it could have benefited small businesses to out of town banks, insurance companies or into stocks and bonds or large public companies located in capital markets concentrated in large cities. Such investments may be riskier than secured loans to the employer since stocks can go down in bad markets (e. g. Chrysler, Penn Central, W. P. Grant Co.) and bonds generally are not secured in the event of bankruptcy. Also, with high interest rates, older "supposedly secure" government and "A" rated bonds have suffered serious losses in value. Also, older mortgages have also lost considerable market value (look at the Savings and Loan Industry).

VI. HIGHER TRUST EARNINGS

A review of our Pre-ERISA records shows that, of the 250 companies whose plans we administered prior to ERISA, 102 had borrowed funds from their plans, 16 had leased equipment from their plans, 12 had leased real estate from their plans and 18 had engaged in other types of "arms length transactions" such as selling third party notes, etc. All of these employee plans had above average earnings records. In fact, our records show that the best returns on investments were realized by those employee plans which loaned part of their funds to the employer company. In general, companies borrowing money from employee plans have been willing to pay interest rates which are as high or higher as the rates charged by local lending institutions. It is noted that there is generally a 5% or more spread between the interest rate a bank will pay on Certificates of Deposit and the rate they charge a low risk borrower.

The trusts earned the higher rate. Overall, earnings for plans of those companies engaging in such transactions ranged from 7% to 12%; plans of other companies averaged earnings of 3% and in some years (1970, 1973, 1974) recorded substantial losses due to stock market losses. Hoever, all of those transactions between plan and employer are now prohibited.

VII. REDUCED CONTRIBUTIONS - LOWER EMPLOYEE BENEFITS

The law does not require corporations to set up new plans or to continue existing plans. These plans are voluntary. However, the existing complex regulations and their lack of flexibility have kept many firms from forming pension plans. The result is that only 45% of employees over age 16 and 54% of those in the 25-to-64 age group are covered. The bulk of those who are not covered work for small businesses, which complain that the expense of setting up pension plans could force them out of business. Efforts to devise simplified plans for these employees haven't caught on, say industry experts, because the so-called simpler plans still remain far too complicated and expensive, and contain unfair restrictions such as the prohibited transaction rules. ERISA, accordingly to an April 21, 1980 article in Business Week, is trying to ensure more golden eggs for pensioners, has spawned rules so complex, so ambiguous, and so burdensome that the goose itself is being killed - not with a bang but a gasp of exhaustion. Plans have been terminated, even if only by the tens of thousands instead of the hundreds of thousands that some were forecasting. (Actually, the death rate is higher if one counts new plans that simply have not been adopted). Existing plans have been drastically changed to get out from under tough new rules, and benefits have been curtailed.

Prior to ERISA, smaller private businesses were willing to make annual contributions to the plans knowing that they could borrow trust funds by providing adequate security and by paying at least the "going rate" of interest. They did not have to make a choice of whether to contribute money available out of current profits to an employee retirement plan or to use it to cover the necessary cost of expansion programs, inflation costs of inventory or other similar foreseeable expenditures. They could do both.

Because ERISA no longer permits loans to an employer even with adequate security and a reasonable rate of interest, a number of my clients have had to reduce their profit sharing contributions from a previous 15% of covered payroll to a current 10% or lower. Some of my clients have even discontinued their plans entirely. I estimate that already over 2,000 employees have been affected by the reductions, and additional clients are seriously considering reductions in their annual contributions. In order to illustrate the impact of those reductions, consider the following:

A. An employee, age 25, on whose behalf an annual contribution of $1,500 is made will receive $190,000 at age 65;

B. The same employee would only receive $127,000 if the annual contribution were reduced to $1,000, or $63,000 less. This means $530.00 per month less income due to ERISA rules.

The above figures are based on averge yearly earnings of 5%. The loss above is attributable to ERISA, which is hurting the very people who were supposed to benefit from it. ERISA has legislated the employees out of the benefits it was designed to protect. And these figures do not reflect the losses due to plan terminations or to the refusal of certain employers to start new plans which they otherwise might have established.

There are other negative results which are just as dramatic. As previously stated, ERISA's excessive restrictions on secured plan investments have had the effect of substantially reducing the annual earnings of many of the employee trusts that we administer. If the effects of reduced contributions and reduced annual income are combined, the results are very startling. Assuming $1,500 is contributed annually for each employee and accumulated at 9% per year, the balance in the employee's account at the end of 40 years will be $552,400. If only $1,000 is contributed annually to the account and the annual income is 5%, a reasonable expecation based on investing one-half in the stock market and one-half in fixed income investments, the balance at the end of 40 years would be only $127,000. This means that the employee would get $425,400 less in retirement benefits. These are very serious negative consequences of ERISA which I feel should be taken into account in any review of the law.

VII. IMPACT ON PRODUCTIVITY, BUSINESS EXPANSION, NEW JOBS

One of our country's serious current problems is the lack of productivity. According to the U. S. Chamber of Commerce, lag in productivity has cost each U. S. household $3,700 in annual personal income over the last ten years and will cost each household an additional $4,800 by 1988. Furthermore, America's productive capacity is sadly out of date. Since 1950, our nation's productivity has slipped more than 50 percent. In productivity, the U. S. now ranks only seventh among industrialized nations. The average age of manufacturing plants in Japan is 10 years; in Germany, 12 years; and yet in the United States the average age of our plants is 20 years.

This lag in productivity is due in large part to restrictions placed on small businesses. President Reagan shares that belief as he evidenced by the following statement in a position paper sent to the National Small Business Association prior to the election: "The success of our economy is critically dependent upon the preservation of real opportunity for small business." And later he talked about the need for reducing income taxes "to encourage entrepreneurship and investment."

Evidence is mounting that small companies are more innovative and create more jobs per dollar of investment than their larger counterparts. In 1979, David L. Birch of the Massachusetts Institute of Technology, in a vast study, confirmed the importance of young, small firms in creating new jobs. Birch studied the activities in the early '70s of 5.6 million businesses that accounted for roughly 82% of all private sector employment. Birch found that two-thirds of the total employment growth came from companies with fewer than 20 employees and that most of those companies were less than five years old.

It is estimated that the small business community contributed roughly 50 percent of this nation's Gross National Product, and close to 60 percent of all U. S. workers are employed by small businesses. In addition, since 1953, more than half of all patentable inventions have been developed by small businesses, and according to a National Science Foundation study, small businesses are 24 times more efficient than large businesses at developing innovations. Also, in the last decade, small business created 70 percent of all new jobs, government created 29 percent, and big business created 1 percent. If only half of America's small businesses hired one new employee, there would be no unemployment.

The President's Council of Economic Advisors has concluded that the increase in productivity is due to: (1) slower growth of investments; (2) diminished research and development; (3) increases in social regulations; (4) more inexperienced workers. Congress can address all four of these problem areas by easing the restrictions on employee benefit plans in a way which will facilitate the accumulation of available funds for small businesses and promote local job security and stability. It requires over $30,000 of capital to create a local job. Declining productivity must be halted through investment in new local plants and equipment. ERISA has eliminated this source of capital for smaller businesses.

Pension and profit sharing assets are now estimated to exceed $600 billion and are projected to exceed $1 trillion by 1985 and 3 trillion by 1995. These assets will significantly affect the structure of capital markets of the future. According to a recent statement in Pension and Investment News, contributions and trust earnings of the U. S. private pension area amount to $30 to $40 billion annually.

Small business has had an important role in the formation of $600 billion in trust funds and in the annual build up of $30 billion. Because of ERISA, these local funds are now being channeled into investments in stocks and bonds of large corporations. The irony is that these large corporations have various sources for adequate financing through banks and insurance companies, bonds and stocks registered with the S.E.C., whereas small business has a difficult time finding adequate financing. If the laws on prohibited transactions and "prudent man" investments were amended, a great deal of capital could be invested in small businesses. Governor Brown of California recently stated that pension funds should be encouraged to invest in the small to medium-sized firms on the cutting edge of new technologies and with the greatest growth potential "to be the IBMs 10 and 15 years from now." Brown also noted that a quarter of all U. S. capital investment now comes from pension funds and that that will increase to half by the late '80s. He warned that conventional application of the "prudent person" rule is "imposing such a conservative standard that the availability of risk and innovative capital - our best guarantee of economic prosperity - is being constrained.

Everyone would benefit from a change in the laws: small business would have operating capital, employees would have more job opportunities, and pension trusts would have promising investments. One factual example of this statement is provided by one of my large clients. It expanded its workforce from 60 employees in 1962 to over 1000 today. Capital to finance that growth came from funds borrowed from its retirement plans. Furthermore, the return earned by its profit sharing plan has been high. However, because that source of capital has been removed, the company now contributes only 10% of profits to the plan instead of its traditional 15%. The 5% difference must now be used for operating capital rather than for employee benefits.

IX. ERISA ENACTED WITHOUT ADEQUATELY CONSIDERING SMALL BUSINESS

I believe that the legislative history of ERISA shows that its prohibited transaction provisions were enacted without sufficient consideration of their possible effect on smaller privately-owned business. My staff has studied the Congressional Record, trying to find discussion of the need for these provisions. We found that nearly all of the testimony and discussion in the record concerned problems which were addressed mainly by ERISA's funding standards and vesting requirements.

During the hearings, abuses of employee benefit plans were cited. But, the fact that abuses were cited does not mean that the then existing standards were inadequate. The abuses cited were as much in violation of the then existing standards as they would have been violations of ERISA's stricter ones. I have found only three instances cited before Congress as an abuse where a transaction between an employer and an employee benefit trust which appeared to have satisfied the "arms lenth" requirements of pre-ERISA prohibited transaction provisions later became a problem.(1) It would appear that the IRS should have uncovered those abuses in two of the three cases cited through an audit Form 990-T. The abuses were obvious violations of the then existing standards. Stricter standards were not needed to cure these abuses - just better enforcement.

In general, however, discussion of prohibited transactions at those hearings was virtually nonexistent; furthermore, what little discussion did occur indicates that the new prohibitions were enacted only to facilitate enforcement activities of the government based on the assumption that employee benefit plans should be subject to the same restrictions as private foundations. Congress may have punished employees and the great majority of law abiding companies for "sins" of the few without adequate study as to the effect on employees and business growth. Ninety-Three (93%) percent of the plans are for small business. None of the cited abuses appeared to involve smaller non-public business.

There are good reasons why these investments of our smaller privately-owned business pension and profit sharing plan funds have been so safe and yet profitable. In all of our plans, the owners of the businesses are also employees of the business and serve without pay as co-trustees of the trust thereby reducing trust administration expenses. Because the owners are often higher-paid employees, they have a significant beneficial interest in the success of plan investments aside from their personal liability as co-trustees, usually as great a financial interest as any other employee. In addition, in many of our plans, the owners of the business personally guarantee plan investments so that these owners would have to lose everything they have before the employees would lose anything. I am convinced that there have been safeguards like these which have proved to be the best means of protecting employees' interests and maximizing their benefits.

Obviously, there is a need for enforcement capability, but ease of enforcement should not be the only consideration when Congress is changing rules of law which so dramatically affect such a large segment of the working population. Most enforcement activities related to ERISA should be directed a policing the funding and vesting requirements since these deal directly with the problems cited in Congressional hearings. Congress should have realized that the prohibited transaction provisions would result in termination of many employee plans and reduced funding of others. If these effects had been compared to the expected benefits, I am sure that the law would not be what it is.

X. ERISA MUST BE IMPROVED

Based on my experience with smaller privately-owned business retirement plans, both before and after ERISA, I am firmly convinced that the prohibited transaction provisions of ERISA should be amended. It is not that the employees' equity interest should be given less protection. On the contrary, effective safeguards such as arms length requirements, security for loans, and personal liability of trustees, should be retained, perhaps even strengthened further.

The point is that to a certain extent, the prohibited transactions under ERISA are ineffective and even detrimental to employees' interests and, therefore, they should be changed so that they continue to protect employees, but without the unnecessary and unreasonable restrictions which have only caused harm to the employees by reducing their benefits.

The main problem with the prohibited transaction provisions of ERISA is that they are based on the presumption that the trust funds should be divorced from the company so as to avoid "conflict of interests" and consequently they prohibit absolutely any buying or selling, leasing, or borrowing between an employer and employee benefit trusts, even though in a particular instance such a transaction might be in the best interests of the employees. The source of funding for an employee retirement plan is the same business which provides the employee with his job. A successful plan and trust must have recurring and substantial contributions. A conscientious trustee must look to the continued good health, success, profitability and growth of the business which created the trust and is its primary source of continued support. No one has convinced me that it is unwise, abusive, or a misuse of employee trust funds to properly invest these funds on a secured basis with the originator and primary contributor of the trust where evidence shows that both the company and the employees can thereby benefit. Recently, the Second U. S. Court of Appeals ruled that it was prudent for the trustees of the New York City Teacher's Retirement System to buy the city's bonds, because it improved the chances of the city being able to continue its annual contributions to the Retirement System. This was when the city was in danger of going bankrupt. The reasoning of the court in this case would apply just as well to the investing of small business retirement plan funds back in to the business. The court found that as a result of the investment, the city was able to continue functioning and to continue approximately the same contribution to the Retirement System as it had been making prior to its final crises. This is a vivid illustration of the kind of opportunity to use pension funds to benefit both employer and employees which was used very successfully in the public sector, but is denied small privately-owned businesses by ERISA. ERISA does provide a method for applying for an exemption to the prohibited transaction rules. However, most class exemption applications have taken at least three years to process. Governments' obvious reluctance to grant reasonable exemptions has resulted in costly and burdensome work on the part of trustees in submitting applications and in interpreting the conditions and restrictions placed on any exemptions which are granted.

In addition, even after long delays, some exemptions are not granted even where the transactions are reasonable and no abuses have been shown to exist. The result is that exemptions are not a quick, easy, or certain method of working around the unreasonable affects of the prohibited transaction rules.

XI. PENDING LEGISLATION SENATE BILL #1541

A bill to amend ERISA is now pending before this body. The findings and declaration of policy contained in House Bill H.R. 4330 and in its companion Senate Bill #1541, state that multiple agency administration of the pension laws has slowed commerce, prevented a rational national pension policy, resulted in costly compliance for employers, harmed the interests of participants and sponsors, and generally caused inefficiency. As a person directly involved in setting up and administering pension plans, I wholeheartedly agree with those negative findings.

Furthermore, I agree with the general goals of the pending legislation --- that is, the encouragement of plans and the simplification of compliance.

I agree with most of the steps proposed to achieve those goals such as the establishment of the Employee Benefit Administration to take over the ERISA enforcement authority now held by the IRS and DOL.

However, my main purpose in commenting on this legislation is to favorably comment on Section 3505 of the new bill which would amend Sections 406(a)(1) and 408(b)(1) of ERISA, the sections dealing with prohibited transactions. As I previously stated, ERISA in its current form prohibits an employer from borrowing money from its pension plan even if there is adequate security and a payment of the going rate of interest for such loan. That prohibition harms the employer by depriving it of a source of locally generated new operating capital. It harms the employees by eliminating a secured and productive investment of their pension funds. It also discourages corporate growth, may reduce an employer's contribution to a plan, or may even result in the termination of a plan.

In short, a secured trust loan to the employer is a "double benefit": a benefit for employees through higher company contributions, higher interest earnings, more and higher paying jobs, and a benefit for the company by having capital for growth.

In the pending bill, the following changes would be made:

1. Section 406(a)(1) would be amended to allow any sale, lease, or the exchange of any type of property between a plan and a party in interest if there is fair consideration. It would also allow a loan between such parties if there is adequate security and a reasonable rate of interest.
2. Section 408(b) would no longer treat as a prohibitive transaction any loan to an employer or any lease of personal property between an employer and a plan if there is reasonable interest, adequate security, and (in the case of loans) the term is for no more than ten years.

Those changes would properly amend the law on prohibited transactions so as to eliminate the problems I have mentioned previously.

In summary, this pending bill would achieve not only the general goals of encouraging more plans and simplifying compliance, but it would also accomplish the specific amendment of some unfair and impractical requirements in the prohibited transaction laws. Therefore, I urge your support of this bill.

References

(1) Legislative History of ERISA, April 1976--Prepared by the Subcommittee on Labor of the Committe on Labor and Public Welfare, U.S. Senate--Volumes I-III, Fiduciary Responsibility Section.

Vol. 1, p. 32 and 33 states that committees recognize practices that are accepted in commercial transactions, but difficult to establish definitive criteria concerning these practices and need to protect workers funds outweighed any current attempt to define all practices.

Vol. 1, p. 46 and 953--Any fiduciary who breaches his trust is personally liable for losses resulting from such breach.

Vol. 1, p. 1100--"Arms length standards" require substantial enforcement efforts, resulting in sporadic and uncertain effectiveness of these provisions. A similar problem was faced by Congress in 1969 regarding private foundations. Congress then concluded that "arms length standards did not preserve the integrity of private foundations" and amended the law to eliminate the problems involved. The committee's bill generally follow the 1969 law.

Vol. 1, p. 1162--An employer needing working capitol or in bad financial condition may forego a deduction in order to divert trust assets to his own use and the trust fiduciary may acquiesce in his demands. The new bill imposes to nondeductible taxes, a 5% tax for each year and a 100% tax.

Vol. 3, p. 4795--Notable examples of abuse resulting from conflict of interest in handling of pension plan assets. These abuses have been developed through Congressional and D. O. L. investigations, and court litigation. For example, in 1960 the pension plan of a large retail store purchased real estate for $625,000 and in 1968 resold it back to the store for $625,000 and 8 months later the store sold it for $2,385.00.

Another example, in 1968 President of X Company took over for Y Company and directed that $6 million of Y's pension fund be invested in Y Company, even though Y had lost $62 million since 1961. The union sued the President of X and two other officials of Y for the $6 million. The President had the Board of Directors of Y pass a resolution saying that a plant would be closed unless the union withdraw the suit and invested an additional $4 million in Y.

A third example was a George Barasch's domination of two unions gave him control of $15,500,000 union pension fund. This sum was held and invested in assets of several companies he formed because he was the lifetime sole trustee of these funds. He also, with trust loans, established a management firm to administer these funds. He formed foreign companies and "research foundations" with total diversions of $5 million. He received a salary of $35,000 from the management firm, $407,000 life insurance coverage, and a pension of $54,098 per year valued at $796,925. Under pressure from the Senate and others, he returned $4.2 million and resigned as trustee.

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February 11, 1982

Senator Don Nickles
Chairman
Labor Subcommittee
Senate Labor and Human Resources Committee
4230 Dirkson Senate Office Building
Washington, DC 20510

Re: S.1541, The Retirement Income Incentive and Administrative Simplification Act of 1981

Dear Mr. Chairman:

We would like to take this opportunity to express our views on Subtitle E of the above-referenced bill. Subtitle E would amend the fiduciary responsibility provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). In general, we support the objectives of the bill. A number of the provisions would be very helpful in clarifying ambiguities in the present provisions of ERISA, and would reduce certain cumbersome and unnecessary requirements. In this regard, the provisions relating to establishment of plans and trusts and fiduciary duties, and those relating to co-fiduciary responsibility are especially helpful.

The provisions of the bill, contained in section 3505, which would establish an "adequate consideration" criterion for transactions which are presently prohibited under section 406(a)(1) would significantly simplify one of the most unnecessary complex and burdensome portions of ERISA. We are concerned, however, that such a standard might permit serious abuses by certain unscrupulous parties in interest of employee benefit plans and, because of the difficulty of enforcing such a standard, it would tend not to have the beneficial prophylactic effect of the present per se prohibitions. Rather than modify the present prohibitions, we would recommend instead that the definition of "party in interest" in section 3(14) be amended to reduce the coverage of the prohibitions in section 406(a)(1) to those persons with a close relationship to a plan who might reasonably be considered to be in a position to abuse that relationship.

Senator Don Nickles
Chairman
Labor Subcommittee

February 11, 1982

Finally, we would like to comment on section 3511 of the bill which would exclude the assets in a pooled separate account of an insurance company or in a collective investment fund of a bank from being considered to be plan assets for purposes of sections 406 and 407 of ERISA. Although we support those provisions, we believe they should be expanded to encompass assets in a pooled fund managed by an investment adviser registered under the Investment Advisers Act of 1940. Such an expansion of the proposed provisions would retain the present competitive parity among those three types of enterprises which may qualify as "investment managers" of employee benefit plans under section 3(38) of ERISA. All three types of entities are subject to extensive federal or state regulation and all three types manage various pooled investment vehicles for the investment of the assets of employee benefit plans. In order that employee benefit plans have available the widest possible array of investment opportunities in commingled funds that are managed by responsible institutions which qualify as investment managers under section 3(38), we strongly urge that commingled funds managed by registered investment companies be accorded treatment equal to that accorded such funds managed by banks and insurance companies. If it is felt necessary that further qualifications be required of those types of entities, such as financial conditions, any requirements should be applied uniformly to all three types of entities. Lastly, we suggest that it may also be appropriate, as plans increasingly participate in non-traditional investments, to consider enlarging the universe of types of entities that may be considered qualified to manage plan investments.

Thank you very much for this opportunity to present our views.

Very truly yours,

Howard Pianko

Robert R. Bitticks

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STATEMENT BY

JOHN R. PRICE

SENIOR VICE PRESIDENT
MANUFACTURERS HANOVER

AND

CHAIRMAN
U.S. CONFERENCE OF MAYORS
ALLIED MEMBERSHIP PROGRAM

ON

S.1541, A BILL TO AMEND THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, AND THE INTERNAL REVENUE CODE OF 1954

FEBRUARY 8, 1982

For the past year, I have been the Chairman of the U.S. Conference of Mayors Allied Membership Program. It is an effort on the part of the Conference to obtain a continuing stream of information and advice from private profit and non-profit organizations interested in urban affairs. I also chair an Advisory Committee on Development Finance made up of nationally recognized real estate developers, leaders in the world of finance, and mayors representing a diverse cross section of cities in the United States. The Committee was created in responsed to recognized needs of cities for dealing with changes in federal policy, in economic conditions, and in the significant restructuring of financial institutions. It has had two meetings during the past year. The first focused primarily on development issues in downtown areas. The second had its primary emphasis on approaches to financing downtown development. The purpose of these meetings was to bring together experts, particularly from the financial community, with developers and mayors in an informal setting to discuss the manner in which private sector resources can be made available to municipalities in order to develop their downtown areas.

The manner in which cities carry out urban development has changed in many ways since the urban renewal program began a generation ago. Many lessons about urban development should have been learned. Perhaps the most important conclusion is that the further the development projects stray from the dictates of private market forces, the greater the public subsidy required.

A number of urban development failures scattered around the country illustrate the hazards of attempting to satisfy public urban development policies without proper consideration of private economic forces. In today's climate it is clear that the public dollar must be stretched further by carefully linking it to national and regional capital markets as well as local sources of financing.

The first meeting of the Advisory Committee on Development Finance identified the fact there is a significant private market for certain types of real estate development in downtown areas of many cities. In the past few years there has been a significant amount of private investment in office and hotel construction in the nation's top 100 cities. These cities are also experiencing construction and renovation of retail and commercial facilities within their boundaries. One major shopping center developer whose business has traditionally been in suburban areas now divides activity equally between central cities and outlying areas. The massive subsidies of the past may not be as necessary in the future in order to achieve certain types of downtown development in major cities. The developers, financiers, and mayors on the Advisory Committee reviewed non-financial government incentives such as sound planning and development policy, improved administration, regulatory relief, and others for attracting entrepreneurial interest and private financing to cities. The Advisory Committee has been discussing how to tap market forces with a limited amount of public aid by giving more attention to the non-financial incentivew which local government, in cooperation with others, can provide.

The Advisory Commitees has not, and has no plans to deal with issues of social investment. A conscious decision was made to limit the work of the Committee to downtown development, which is justified principally by private market considerations. Other Allied Members of the Conference are concerned about and providing advice on social investment and corporate social responsibility.

The Advisory Committee on Development Finance meeting in New York on January 14th focused on financing by major institutions with a special emphasis on pension funds. Only a limited portion, less than 5 percent of the estimated $850 billion in pension funds is devoted to real estate. Participants at this meeting indicated that the portion of pension funds devoted to real estate would increase several fold in the near future, and it is expected that there will be a very rapid growth in total pension fund dollars. Therefore, pension funds can become an important source of financing for downtown development. The New York meeting addressed investment criteria currently used by pension fund managers, barriers these managers feel exist to real estate investment in cities, and the types of projects mayors are interested in having in their downtown areas. Arrangements which could facilitate bringing mayors and institutional sources of capital together were a major topic of discussion. There was a clear recognition by all participants that the basic purpose of pension funds is to provide a secure source of income for covered employees when they retire. There was also universal acceptance of the importance of the fiduciary responsibility of the pension manager. At the same time there was a strong interest in understanding the rules of the game so that city governments can structure public development goals for downtown areas in ways which would be compatible with the investment objectives and procedures of pension funds.

Based on the work of the Advisory Committee and in a review of current rules and regulations, it is apparent that new government policy could facilitate urban development investment by pension funds. We are therefore pleased that S.1541 addresses issues such as the fiduciary responsibilities of pension fund managers and prohibited transaction rules in a serious fashion. We are also mindful of the Department of Labor's proposed class exemption covering residential mortgage financing transactions. We hope that the Congress and the Administration will provide administrative and legislative relief which, while maintaining clear, legal fiduciary responsibilities, will enable pension fund managers to make prudent investments in downtown real estate development. Economics has made many profitable investments available to downtown areas throughout the country. Federal law and regulations should not frustrate the efforts of pension fund managers to take advantage of these opportunities.

There may be a number of approaches to simplifying the procedures for dealing with prohibited transactions and ensuring that investments do not violate rules regarding parties-in-interest. One approach, which I favor, would be to eliminate the prohibited transaction section of the law. The existing requirements for fiduciary responsibility provide essential protections.

However, another approach is that contained in section 3511 of S.1541. This proviso gives a blanket exclusion for certain types of financial institutions which are already regulated by other government entities. It would, in effect, remove from the coverage of the prohibited transaction section of the law a significant portion of all pension fund dollars. Still another approach would be to simplify the administrative process by which class exemptions for certain types of transactions are given.

There is also a question about what can be done administratively and what requires action by the Congress. It would be desirable for the federal government to proceed as quickly as possible administratively to eliminate unnecessary regulations which frustrate the ability of pension funds to take advantage of profitable opportunities in downtown areas. As a minimum, the Department of Labor should broaden the current proposed class exemptions to include other types of development. It is clear that office, retail, and commercial development offer sound investment possibilities for pension funds.

The proposals in S.1541 for simplifying and updating the Employee Retirement Income Security Act, especially the provisions regarding prohibited transactions, would facilitate and encourage new types of arrangements between cities, financial institutions, and real estate developers. They could have the benefit of helping to achieve important public purposes in a period of significant social and economic change. We would be please to work with the Committee in perfecting S.1541.

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February 12, 1982

Senator Don Nickles
4230 Dirksen Senate Office Building
Washington, D. C. 20510

Re: Retirement Income Incentives and Administrative Simplification Act of 1981 - S1541

Dear Senator Nickles:

We would like to submit the following comments with respect to the amendments to the fiduciary provisions of the Employee Retirement Income Security Act of 1974 ("ERISA") proposed in the Retirement Income Incentives and Administrative Simplification Act of 1981, S1541 ("S1541").

Exclusion from Plan Assets of Investments in Pooled Separate Accounts and Collective Investment Funds

S1541 would amend Section 408 of ERISA to exclude from the definition of plan assets for purposes of Sections 406 and 407 of ERISA, investments in insurance company pooled separate accounts and bank collective investment funds in which five or more unaffiliated plans participate and in which no plan or affiliated group of plans holds a 50 percent or more interest.

The proposed amendment, however, would not extend to collective investment funds sponsored by persons other than banks and insurance companies who may be subject to no less rigorous state or federal regulation. There appears to be no basis for limiting the proposed amendment to banks and insurance companies. Section 3(38) of ERISA explicitly defines the term "investment manager" to include registered investment advisers under the Investment Advisers Act of 1940, thereby recognizing that the Investment Advisers Act's disclosure, antifraud and recordkeeping requirements as well as audits by the Securities and Exchange Commission and independent auditors afford employee benefit plans protection that is comparable or greater to that provided where a bank or insurance company acts as "investment manager." In addition, plans may invest in similar collective investment funds sponsored by entities who are not registered investment advisers, but who could demonstrate to the Secretary their qualifications to sponsor such funds e.g., non-bank custodians and registered broker dealers. See Treas. Reg. § 1.408-2(b)(2). We believe the assets of such collective investment funds should also be excluded from plan assets.

We are aware of an increasing use by plans of group trusts and other collective investment vehicles sponsored by entities other than banks or insurance companies. The prohibited transaction and plan assets problems that arise in connection with the operation and management of such vehicles are no different than those encountered by pooled separate accounts and bank collective investment funds. In view of the opportunity for diversification and professional investment management such vehicles provide plans, S1541 should provide equal treatment to all collective investment funds sponsored by qualified persons.

S1541 would add a new statutory exemption to Section 408 of ERISA exempting from the prohibited transactions provisions of Sections 406 and 407 of ERISA, loans made by a defined contribution plan to a party in interest who is a substantial employer (i.e., an employer which contributed not less than 75% of all employer contributions during the preceding plan year) maintaining the plan if the loans bear a reasonable rate of interest which is consistent with the fiduciary duties under Section 404 of ERISA, are adequately secured and are limited to a term of not more than 120 months.

While Section 407 of ERISA presently permits loans by an "eligible individual account plan" to a sponsoring employer such loans are limited by the restrictions of Section 407(e) of ERISA to loans where: (1) not more than 25% of a particular debt obligation issued by the employer is held by the plan; (2) at least 50% of such issue is held by persons independent of the employer and (3) not more than 25% of the assets of the plan are invested in obligations of the employer. The proposed amendment to Section 408 of ERISA would substantially broaden the existing statutory exemption for a loan by plans to sponsoring employers by permitting investments of up to 50% of the fair market value of the plan's assets in such loans and by eliminating the restrictions set forth above.

In our view, the existing statutory exemption for loans to employers and the possibility of obtaining an administrative exemption for loans not covered by the statutory exemption are protective of the interest of plan participants and are satisfactory for purposes of administering employee benefit plans. Section 3508 of S1541 would, in effect, reinstate the "adequate security" provisions of the pension law prior to ERISA. The problem we find with this provision is that substantial employers who are in financial trouble are the employers most likely to attempt to rely on the statutory exemption. As the provision is self operative there is no opportunity for administrative review. If the substantial employer cannot repay the loan and the security turns out to be inadequate, there is little recourse on behalf of the plan participants. We do not believe the lessening of the administrative burden provided by Section 3508 with respect to loans to substantial employers justifies the increased possibility of a loss of benefits for plan participants.

Clarification of Exculpatory Provisions Permitting Indemnification

S1541 would amend the indemnification provisions contained in Section 410(b) of ERISA to make clear that a plan may indemnify persons who are fiduciaries with respect to multiemployer plans against expenses including attorneys fees, amounts paid in settlement and liability for losses incurred in connection with certain administrative and civil actions. To some extent the amendment parallels the position articulated by the Department of Labor and at least one court that a plan may advance expenses to fiduciaries prior to an adverse determination by a court or administrative tribunal. *See Central States, Southeast and Southwest Areas Pension Fund* v. *American National Bank & Trust Co. of Chicago*, No. 77 C4355 (N.D. Ill., October 26, 1979). Moreover, the amendment makes clear that indemnification may be provided for amounts paid in a settlement. The amendment, however, would not extend to plans other than multiemployer plans. There appears to be no basis for this distinction. We believe if this provision is enacted it should be available to fiduciaries with respect to plans other than multiemployer plans.

Respectfully submitted,

Weil, Gotshal & Manges

Weil, Gotshal & Manges

STATEMENT
OF
TEAMSTERS FOR A DEMOCRATIC UNION
BEFORE THE
SUBCOMMITTEE ON LABOR OF
SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES
ON
THE FIDUCIARY PROVISIONS OF S.1541

Arthur L. Fox II

and

Joseph Keffer

Febrary 10, 1982

Teamsters For A Democratic Union/PROD is a nationwide organization of rank and file Teamsters attempting to make the Temasters union more democratic and responsive to the needs of the members. Today, TDU has a membership exceeding 8000, organized into nearly 50 chapters nationally. TDU reaches approximately 60,000 Teamsters through its newspaper, CONVOY DISPATCH.

In 1940 the total assets in private pension arrangements was 2.4 billion dollars. By September, 1981 the assets of the 1000 largest employee benefit funds had grown to 519 billion dollars, an increase of approximately 10% over the year before. It is estimated that pension plan assets will increase to approximately 3 trillion dollars by 1995.

The meteroic increase in pension funds was a natural target for abuse. One of the most blatant of the pension fund scandals involved the Teamsters Central States Pension Fund. Investigations in 1969 revealed that Fund managers had channeled millions of dollars into loans, usually unsecured and at no interest, to support suspicious operations. Federal officials in 1977 estimated that the fund may have lost between $500 and $700 million -- perhaps as much as one-half of the fund assets-- because of bad investments.

Prior to the enactment of ERISA, the Labor Department lacked standing to sue to remedy such fiduciary violations. Theoretically, the beneficiaries of such funds, rank-and-file workers, were left with the task. However, because the cost of prosecuting a suit is great and the defendants can defend themselves with almost limitless trust fund assets, and further because one beneficiary's interest in a favorable result is likely to be a very small fraction of the costs he/she would have to incur to secure the result, practically no remedial litigation was ever undertaken.

The Congress took steps when enacting ERISA to remedy this problem. It gave the Department of Labor authority to sue on behalf of pension fund beneficiaries to remedy fiduciary violations, it spelled out the duties of fiduciaries and prohibited certain party-in-interest transactions where the temptation for abuse is practically irresistable unless one is almost certain of being caught. Because of this temptation, and because Congress' investigations had established that most fiduciary violations had accured in such transactions, the Congress wisely built a presumption into the law that they were unlawful. However, where the parties can rebut that presumption to the satisfaction of the Department of Labor, they can obtain exemptions.

Naturally, the large, scrupulous institutional pension fund mangers, who properly command respect in the Congress and elsewhere, consider this rule to be a nuisance. They are the ones most often applying for exemptions and complaining of lost investment opportunities as a result of time required to consider their exemption applications. However, as inconvenient as the rule may be to this class of pension fund fiduciary, it has been even more inconvenient to many more fiduciaries who never bother applying for exemptions because they know the transaction they would like to make would never qualify for an exemption since it would in fact amount to a blatant fiduciary violation. The point is simply that the prohibited transaction provision in ERISA has served an incalculably significant prophylatic role in stemming fiduciary violations which jeopardize the pensions, and hence the financial security of millions of hardworking American workers.

S.1541 would, if enacted, change this feature of ERISA in a dramatic and deleterious way. The bill would substitute for the ban on so-called prohibited transactions, a post-transaction test based on whether there was adequate consideration. It would shift the burden of proof from the fiduciary back to the beneficiary (or the Secretary) who would have to discover, and then attempt to remedy fiduciary violations. Policing an "adequate consideration" standard would be almost impossible. For reasons which have already been developed, pension fund beneficiaries are totally unable to accomplish this task, and the Secretary of Labor is little better equipped to do so. The heart and soul of ERISA would be ripped from the statute and it would soon be "business as usual" once again for the crowd of unscrupulous people who formerly preyed upon pension funds. Although the honest institutional investors and the funds they handle would obviously profit by enactment of S. 1541, unfortunately so also would many others at the expense of millions of workers.

In balance, we cannot afford to relax the prohibited transaction rules particularly where the Department of Labor can, and has announced its intention to promulgate rules for granting class exemptions to institutional fund managers that should satisfy their objections.

Phone: (412) [illegible]

United Steelworkers of America

FIVE GATEWAY CE RGH, PA. 15222

Lloyd McBride
International President

FEB 4 1982

January 25, 1982

Honorable Donald Nickles
Chairman, Subcommittee on Labor
Committee on Labor & Human Resources
United States Senate
4230 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

I regret that my schedule does not permit my participation in the Subcommittee's hearing of January 26, 1982 on S. 1541, The Retirement Income Incentives and Administrative Act of 1981.

As you know, the United Steelworkers of America has a strong interest in any legislative proposals relating to ERISA, including S. 1541. Accordingly, I would request that the enclosed statement be included in the record of the Subcommittee's January 26th hearing.

Sincerely yours,

Lloyd McBride
President

LMB/bja

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STATEMENT OF
LLOYD MCBRIDE, PRESIDENT
THE UNITED STEELWORKERS OF AMERICA

UNITED STATES SENATE
COMMITTEE ON LABOR AND HUMAN RESOURCES
SUBCOMMITTEE ON LABOR
S. 1541

JANUARY 26, 1982

On behalf of the United Steelworkers of America, I would like to thank you for the opportunity to place this statement into the record as the Labor Subcommittee considers those Sections of S. 1541, The Retirement Income Incentives and Administrative Supplements Act of 1981, which relate to fiduciary responsibility. Our nearly 1.3 million members strongly believe that high standards of conduct for fiduciaries are essential to the attainment of true retirement income security for workers. Therefore, any consideration of amendments to the current provisions in ERISA are of direct concern to the Union.

The position of the United Steelworkers of America with respect to S. 1541 and other proposals to amend ERISA has not changed from our position as stated at the Labor Subcommittee's November 12, 1981 hearing on Title VI of S. 1541. We continue to oppose the enactment of S. 1541 for three basic reasons:

First of all, the legislative process, particularly as it relates to employee benefit matters, is highly unpredictable.

Secondly, we do not believe that amendments to ERISA are necessary at this time.

Thirdly, we believe that many of the provisions of S. 1541 would significantly reduce worker protections.

These latter two reasons, we believe, are particularly compelling with respect to the amendments to ERISA set forth in Sections 3501 through 3514 of S. 1541.

Most importantly, Section 3505 of the bill would directly alter the nature of ERISA's regulation of transactions between plans and parties-in-interest to plans. At present, such transactions are prohibited, unless they are exempted from the general prohibition pursuant to exemptions contained in the Act itself or issued by the Department of Labor. Congress enacted this general prohibition in recognition of the potential conflicts of interest and opportunities for abuse which arise when a plan fiduciary or other party-in-interest deals with plan assets. We believe that the Department of Labor has made significant progress in administering exemption applications in recent years and that the so-called "prohibited transaction problem" is no longer a significant one. Almost all of the major class exemptions have been issued. Individual exemption applications are now generally disposed of within three months. The Department of Labor has publicly expressed its commitment to further streamline this administrative process.

We would remind the Subcommittee of the basic fiduciary rules of ERISA, which require fiduciaries and trustees to act solely in the interest of participants and beneficiaries and to handle plan assets prudently. Clearly the ability of the Department of Labor and plan participants to effectively enforce these rules is enhanced under the present methodology. It is far easier to persuade a judge to remove dishonest plan officials and otherwise act to protect participants and beneficiaries when a per se violation of the prohibited transaction rules can be demonstrated rather than having to demonstrate that an inherently suspicious transaction between a plan and a party-in-interest did not involve "adequate consideration", a standard often difficult to establish. At a time when budget restraints will severely limit the ability of the Department of Labor to audit and investigate party-in-interest transactions, the prohibited transactions rules set forth in Section 406(a) are central to the effective enforcement of ERISA's fiduciary standards.

Other amendments proposed in S. 1541 are similarly undersirable. For example, Section 3508 would create a new statutory exemption from the self-dealing rules in Section 406 of ERISA to permit employers who maintain defined contribution plans to borrow up to 50% of the plan's assets. This provision suggests, unfortuantely in our view, that plan fiduciaries, to a greater extent than under existing law, may view plan assets as belonging to the plan sponsor rather than to plan participants and beneficiaries. Surely in light of the very recent experience involving the Grumman Corporation Pension Plan, where the court found that the trustee used plan assets for a purpose other than to benefit plan participants and beneficiaries, this type of investment should not be encouraged.

Many of the changes contained in Sections 3501 through 3514 purport either to codify what the administrative agencies have already accomplished, to remedy so-called "unintended" problems caused by ERISA or to (administratively) make technical corrections. These amendments would change ERISA provisions which, in the real world of pension plan administration, have not been troublesome. For example, when Congressman Erlenborn introduced H.R. 4334, (the House counterpart to S. 1541) he suggested that Section 405(a)(3) as it now stands could be misread to impose co-fiduciary liability upon a fiduciary who "has bare knowledge of the acts or events comprising the breach of another." The solution set forth in S. 1541 to this perceived problem is to delete Section 405(a)(3) entirely. We suggest that the "problem" alluded to has never materialized to the extent suggested by critics of the current law.

Section 3513 would also permit a plan to indemnify trustees against personal liability if they breach their fiduciary duties in good faith. In support of this proposal, Representative Erlenborn contends that the intent is to better enable plans to retain competent trustees. Again, we believe the solution set forth in the bill relates to a problem the existence of which has never been clearly established.

The fiduciary responsibility provisions of ERISA serve as a constant reminder to employers, trustees, administrators and other fiduciaries and parties-in-interest that employee benefit plans must be administered, and assets invested, exclusively for the benefit of plan participants and beneficiaries. These provisions have become a symbol of the Federal Government's commitment to assuring the integrity of employee benefit plans. We beleive that this commitment is of great significance to the participants and beneficiaries of these plans as well as to the American public at large.

The enactment of Secions 3501 thru 3514 of S. 1541 would, in our view, also serve as a symbol that the Congress no longer believes that the integrity of employee benefit plans is vital to American workers and the American public. For these reasons, as well as for those more general reasons set forth in our testimony of November 12, 1981, the United Steelworkers of America opposes the enactment of S. 1541.

CENTRAL STATES
SOUTHEAST AND
SOUTHWEST AREAS
PENSION FUND

EMPLOYEE TRUSTEES
LORAN W. ROBBINS
MARION M. WINSTEAD
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HOWARD McDOUGALL
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EXECUTIVE DIRECTOR
GEORGE W. LEHR

January 25, 1982

The Honorable Donald L. Nickles
Chairman, Subcommittee on Labor
Committee on Labor and Human Resources
United States Senate
Washington, D. C. 20510

Dear Chairman Nickles:

Enclosed is the statement of the Central States, Southeast and Southwest Areas Health and Welfare and Pension Funds on your bill S. 1541, "The Retirement Income Incentive and Administrative Simplification Act," as well as S. 1678, amending the Employee Retirement Income Security Act of 1974 with regard to mortgage investments.

The Trustees appreciate the opportunity to present their views to your Subcommittee and hope to be able to work closely with you in the future development of this and other legislation important to the pension and welfare industry.

Sincerely yours,

George W. Lehr

GEORGE W. LEHR
EXECUTIVE DIRECTOR

Enclosures

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Statement of Mr. George W. Lehr
Executive Director
On Behalf of the Trustees of the
Central States, Southeast and Southwest Areas
on
S. 1541, The Retirement Income Incentives and Administrative Simplification Act
Senate Committee on Labor and Human Resources
Subcommittee on Labor

January 26, 1982

Mr. Chairman and Members of the Subcommittee, I am pleased to have this opportunity to submit this statement on behalf of the Trustees of the Central States, Southeast and Southwest Areas Pension Fund (hereinafter referred to as the "Fund").[*]

The Fund is among the largest multi-employer Taft-Hartley trust funds in the country, serving some 527,000 active participants, inactive vested participants and current retirees and beneficiaries in 34 states. It receives contributions from approximately 15,000 Teamster industry employers pursuant to collective bargaining agreements and currently pays age and disability pension and other benefits totalling $400 million annually. The Fund is administered by eight Trustees, four each from labor and management.

We have carefully studied S. 1541 and its counterpart, H.R. 4330, introduced by Representative John N. Erlenborn. We applaud this thoughtful effort to reexamine ERISA in the light of seven years' experience, and to revise and simplify the law where appropriate while properly maintaining the basic protections of ERISA.

In our view, S. 1451 contains many provisions which we strongly support as improvements in the pension law that would benefit plan administrators, plan participants and beneficiaries.

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[*] The comments and recommendations herein also apply, where applicable, to the Central States, Southeast and Southwest Areas Health and Welfare Fund.

There are other provisions which we would support with some modification.

TITLE I: EMPLOYEE BENEFIT ADMINISTRATION

Three separate federal agencies currently exercise jurisdiction over ERISA: The Departments of Labor and Treasury and the Pension Benefit Guaranty Corporation.

As pointed out in the General Accounting Office study on ERISA administration, released in October 1981, the multi-agency administration of ERISA has for years been plagued by waste, inefficiency, and duplication of effort. Moreover, the three administering agencies have frequently disagreed as to their relative responsibilities and jurisdictional authority and have pursued their own distinct policies, to the detriment of effective ERISA coordination.

The present situation stands in marked contrast to the three-fold policy announced in Section 3(b)(1) of the bill which calls for the consolidation of the administrative responsibilities for ERISA into one agency, The Employee Benefit Administration, in order to:

"(A) foster the orderly growth and maintenance of employee benefit plans and enhance the free flow of commerce;

(B) protect more effectively the interests of participants and beneficiaries in such plans; and

(C) promote the estabishment of effective mechanisms for providing adequate retirement income to a greater number of persons."

The Fund strongly supports this concept of consolidation. If properly planned, this single-agency approach should improve the efficiency of administration of ERISA and thereby significantly reduce the government's costs, provide the capacity for coherent, unified policymaking in the private pension area, and enhance the ability of pension plan administrators to comprehend and carry out the national policies governing private pension plans.

TITLE III: AMENDMENTS TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

SUBTITLE B: AMENDMENTS TO REPORTING AND DISCLOSURE PROVISIONS

Certain provisions of S. 1541 delete unncessary and costly ERISA reporting procedures while ensuring that plan participants and beneficiaries continue to have access to pertinent information. By refining ERISA requirements in this area, the bill would allow plans to apply monies which would otherwise have to be needlessly expended on ERISA administration to instead be applied directly to the funding of pension benefits.

Section 3206: Distribution of Summary Plan Descriptions Every Tenth Year

Current law requires that a document which outlines the salient provisions of an employee benefit plan, known as the "Summary Plan Description", be prepared and distributed to plan participants and beneficiaries every five years. However, in a case where no amendments have been made to a plan during such five-year period, an updated Summary Plan Description need only be distributed to participants and beneficiaries every ten years.

Section 3206 of the bill would extend from five to ten years the interval for filing and distributing an updated Summary Plan Description even when there has been an intervening change in the terms of the plan. Section 3206 would not modify the current requirements that new participants be provided with an updated copy of the Summary Plan Description nor the requirement that all participants be provided with statements of material modifications to the plan after the close of the plan year in which the modifications are made. Since the information which would otherwise be included in a new republished Summary Plan Description will have already been provided to participants, the change proposed by Section 3206 provides plans with a sensible option to reduce their printing and publishing costs.

The Fund feels that this additional flexibility is appropriate for retirement plans in general even though the Fund may choose to maintain a program of more frequent voluntary disclosure. Our Plan is amended after every renegotiation of the National Master Freight Agreement, which occurs approximately every three years. Our Trustees have consistently followed a policy of providing participants with full information. For example, after each negotiation, the Trustees have reprinted the plan document as amended, have prepared a new Summary Plan Description, and have made these updated documents available to the participants. The Trustees no doubt will continue this practice, which indeed is more strenuous than the requirements of current law. Nevertheless, the Fund supports the proposed change of Section 3206 as it gives trustees of all plans greater discretion to make decisions which suit their particular needs.

Section 3207: Publication of Summary Annual Report

Present law requires that a plan file an annual report with the appropriate governmental authorities. An outline of the information set forth in the annual report must also be prepared and individually distributed to plan participants. This outline, referred to as the Summary Annual Report, must follow a format established in Department of Labor regulations.

Such regulations provide that the Summary Annual Report must be distributed within nine months from the close of the plan year (29 C.R.F. Section 2520.104b-10(b)).

Section 3207 of S. 1541 would amend ERISA Section 104(b)(3) to permit an administrator to have the Summary Annual Report posted at the principal work sites of plan participants instead of being required to distribute the Summary Annual Report individually. Section 3207 also directs the Secretary of the Treasury to provide alternative means of Summary Annual Report distribution, including publication in management or employee newsletters. The time period for publication, however, would be accelerated to 210 days (or seven months) after the close of the plan year.

In general the Fund strongly supports the concept of allowing the publication, rather than requiring the individual distribution, of Summary Annual Reports. The Fund feels that the administrative savings which this improvement would generate would be significant. However, the Fund opposes any acceleration in the time period required for the preparation of the Summary Annual Report as we have found that the current time schedule is necessary to enable the Fund to assimilate the data needed for the preparation of the Summary Annual Report.

Our experience also indicates that our participants have found the Summary Annual Report to be the source of confusion and misunderstanding even though we use the language required by Department of Labor regulations. Indeed, many participants have contacted us to express their bewilderment as to its contents.

It is our view that the Summary Annual Report can be made useful, and we would welcome the opportunity to work with the

Subcommittee to devise a format that would be far more satisfactory to plan participants than the current mandated version.

Again, we support the proposal that the Summary Annual Report be posted rather than sent to each participant. In our judgment that will prove to be an appropriate method of distribution—at a more reasonable cost.

Section 3208: Simplification of Notice to Interested Parties Issuance of Determination Letters

The law now contains a procedure under which an employee benefit plan can request a formal determination from the Internal Revenue Service that the plan meets all requirements needed to obtain tax exempt status. The initial determination letter of the Internal Revenue Service is updated, at the request of the plan, each time a substantive modification is made to the text of the plan.

The rather complicated process involved in applying for a favorable determination letter includes the preliminary requirement that all "interested parties" (that is, current and potential participants) be made aware of the pending submission through the posting of an appropriate notice form no later than seven days prior to the date upon which the submission is mailed to the Internal Revenue Service. In situations where the posting would not, in the normal course, be expected to bring the notice to the attention of all "interested parties," the notice must be individually mailed or otherwise distributed no later than ten days prior to the submission date.

Section 3208 of the bill would, inter alia, extend the posting requirement to a period beginning 60 days before the filing date of the determination letter request.

In our view, the notice requirement has not served any useful purpose in practice, and ought therefore to be eliminated. When the Fund last was required to post notice, in 1979, only three responses were received out of a possible 500,000.

If the requirement is retained in the law, however, we believe that the current Treasury regulations, at least as they govern the timing and publication of the notice, are preferable to the modifications proposed in Section 3208.

Section 3212: Alternative Distribution Methods for Multi-Employer Plans

Section 3212 addresses the method for insuring appropriate dissemination of ERISA-required documents to plan participants.

Under current law and regulations, the Fund is required to distribute many of these documents (such as the Summary Annual Report and the Summary Plan Description) by mail to each participant's home address. In the normal course, the Fund will not routinely receive information concerning the change of address of a participant who is currently employed. For a plan as large as ours, the cost of attempting to keep mailing lists up to date, coupled with the cost of duplicating and mailing the documents, has proven to be extremely burdensome. For example, the Fund spent $388,600 in 1980 in an effort to keep its mailing lists accurate. In addition, the cost to us of a single mailing of ERISA-required documents has now reached $75,000.

We feel that our overall efforts in creating a distribution program have been successful and we may decide to retain our present system even if the distribution requirements are lessened. We have been informed, however, that a number of large plans have met with insurmountable difficulty in their attempts to coordinate an accurate address data base and are in desperate need of legislative relief.

Section 3212 would provide this assistance by giving plan trustees the option of discharging distribution responsiblities by providing copies of the required documents to contributing employers or unions which would in turn have the responsiblity of informing the covered employees as to their availability or of distributing the documents, as the case may be.

We strongly support this proposal as being urgently needed in the pension community.

The Fund recognizes that there may be reluctance on the part of some employers and local unions to assume the responsibilities contemplated in the bill. Therefore, the statute should establish "safe harbor" distribution methods which, if followed in good faith, would preclude the employer or the local union from being subjected to liability claims in respect of the disclosure requirements of Title I of ERISA.

SUBTITLE C: PARTICIPATION AND VESTING PROVISIONS

Section 3302: Suspension of Benefits Because of Reemployment

One of the major problems confronting large multi-employer plans is the number of individuals who initially qualify for retirement or termination benefits and then reenter the active work force. As a policy matter, the Fund does not wish to provide benefits to workers who have not truly retired. Section 203(a)(3)(B) of ERISA at present authorizes a suspension of benefits but does not provide any guidelines.

Section 3302 expands Section 203(a)(3)(B) of ERISA by establishing a set of specific rules concerning situations where pension plans can suspend benefits upon the reemployment of retired workers, including retired workers who become actively engaged as self-employed individuals.

The Fund generally supports these provisions which in some cases codify approaches reflected in Department of Labor regulations in this area. We do, however, have several recommendations for additions to the bill, which are based upon our own experience and practices, and which we believe would further assist multi-employer plans in applying benefit suspension rules most effectively and fairly:

1) In any any amendment to ERISA Section 203(a), the legislation itself should contain explicit permission for plans to devise reasonable suspension rules.

Plans should not have to wait for the issuance of administrative regulations in this area.

2) One aspect of current law which would not be modified under the present text of this bill limits a suspension of benefits to a reemployment within the "same industry, same trade or craft and the same geographic area covered by the plan." This restriction puts an unwarranted burden on the Fund to reconstruct, if possible, the reemployed participant's past history. The Fund would instead recommend the establishment of an alternative standard of reemployment under which a plan could recognize for suspension purposes any employment with respect to which an employer is required to make contributions to the plan;

3) The legislation should give multi-employer plans explicit permission to recoup benefits improperly made to reemployed retirees, plus interest, by offsetting future benefit payments to those individuals.

Section 3308: Application of Benefit Accrual Rules in Cases of Delinquent Contributions to Multi-Employer Plans

Under Section 3308 a multi-employer plan would not be required to award credit to an employee for service for which his employer has failed to make required plan contributions pursuant to the applicable collective bargaining agreement.

The Fund strongly supports this provision of the bill. The Section would enable the Fund to avoid the onerous obligation of having to subsidize the funding of benefits for employees whose employers fail to meet their contribution burden. A requirement to continue the accrual of benefits in situations where no monies are received by the Fund would not be in the best interest of the overall fiscal posture of the Fund and could generate long-term consequences which would be adverse to the expectations and entitlements of the many participants who work for entities which conscientiously honor their contribution commitments.

In supporting this provision, we hasten to note with approval that the bill would establish adequate safeguards which would protect the interests of the potentially affected plan participants. That is, the bill would require a plan to promptly notify the local union representing the employees that the employer is delinquent and of the consequences to the affected participants. This notification requirement should assist in the correction of the problem by informing those interests best suited to deal with the matter. In the past the Fund has vigorously pursued delinquent contributions and would continue to do so under the bill. The bill would of course not relieve the trustees of a plan from their duty to take prudent and reasonable steps to collect delinquent contributions.

Sections 3310 and 4310: Alimony and Support Payments

Section 206(d) of ERISA provides that benefits under a pension plan may not be "assigned or alienated." Section 514 of ERISA provides that the provisions of ERISA shall in general supersede any and all state laws dealing with entitlements under employee benefit plans. The scope of both of these provisions has been disputed in recent court cases involving spousal rights to pension payments in the context of alimony, child support and property settlements.

The Fund has been receiving an increasing number of inquiries from divorce attorneys who seek a determination of the projected pension benefits of a participant.

The uncertainties which recent court decisions have introduced with regard to Sections 206(d) and 514 of ERISA have resulted in the increasing involvement of pension plans in family law disputes, with attendant legal costs and administrative burdens, and legislative clarification would be most helpful. Examples of problems which confront the Fund include the following:

1) The legal question may occur before the employee has vested benefits. If the employee subsequently fails to vest, litigation costs and resources have been wasted;
2) The terms of the court order or settlement concerning the commencement or form of benefit payments may conflict with the terms of the pension plan;
3) There is typically a lapse of years between entry of the court order or settlement and commencement of the

benefit; often serious difficulties arise simply in locating the former spouse of the participant.

Until answers to these issues are legislatively established, pension funds will be exposed to action by either a participant's objecting to our compliance with the court order dividing pension benefits or by the participant's former spouse for failure to follow such an order.

The Fund believes the pertinent provisions of S. 1541 go a long way toward resolving these and other serious problems faced by multi-employer plans in this area. These improvements address the concerns of spouses and dependents of participants as well as provide standards to eliminate current confusion and expenses.

SUBTITLE E: FIDUCIARY REESPONSIBILITY PROVISIONS

Section 3503: Refund of Mistaken and Certain Other Contributions

Under current law a multiemployer plan can return to an employer contributions or withdrawal liability payments which such employer previously made to the plan if such contributions or payments were made by the employer pursuant to a mistake of fact or law, provided that such return is effectuated within six months after the plan administrator determines that the payment was made by such mistake.

Section 3503 would extend this six-month period to one year after the date the mistake is discovered. In addition, the Section has a retroactive effective date which would allow all pre-enactment determinations of mistaken contributions to be treated as determinations made as of the date of enactment.

The Fund opposes this provision. It would serve to reopen all past and settled determinations concerning return of contributions and payments, and so cause plans great administrative hardship.

SUBTITLE F: ADMINISTRATION AND ENFORCEMENT PROVISIONS

Section 3601: Actions Relating to Delinquent Contributions

This Section resolves two very important problems which multi-employer plans have encountered in litigation to collect employers' payments of delinquent contributions.

First, Section 3601 makes it clear that multi-employer plans may bring an action to enforce employers' contribution obligations in state as well as federal courts. We support this change. Under current law, plans have been forced to institute their actions in federal court, which sometimes means a slower and more expensive proceeding.

Second, Section 3601 would provide a six-year statute of limitation for ERISA delinquency suits.

In addition, we strongly urge that the Committee authorize a pension plan to adopt a statute of limitations for their purposes which would consist of the greater of (i) six years or (ii) the applicable statute of limitations in the state where a plan is administered.

Section 3605: Preemption

Section 3605 establishes that a participant's right to benefits shall not be considered a security for purposes of either state securities laws or the laws administered by the Federal Securities and Exchange Commission. To find otherwise would subject pension plans to unnecessary additional regulation, which would further increase a plan's administrative burdens.

We support proposed Section 3605 insofar as it strengthens federal preemption of state laws, and we oppose it insofar as it would create two exceptions to federal preemption. These two exceptions would permit states to regulate plans in the areas of (i) providing employees with the right to convert or continue protection after the normal insurance coverage ceases under the applicable insurance policy and (ii) requiring equal consideration and payment of policy benefits in situations where a provider of medical services is not a medical doctor. We do not oppose the concept of incorporating these types of coverage in employee benefit plans -- as a matter of fact our plan currently provides benefits such as these. We do, however, oppose any intervention by states in the areas regulated by ERISA and its amendments.

Mr. Chairman, this concludes our prepared statement. The Trustees and I greatly appreciate the opportunity to submit it for the record and wish to commend the Subcommittee for its keen interest in improving the administration of a program of such vital importance to millions of Americans including active and inactive workers and retirees and their beneficiaries.

Statement of Mr. George W. Lehr
Executive Director
On Behalf of the Trustees of the
Central States, Southeast and Southwest Areas
Pension Fund
on
S. 1678, to Amend the Employees Retirement Income Security
Act of 1974 with Regard to Mortgage Investments
Senate Committee on Labor and Human Resources
Subcommittee on Labor

January 26, 1982

Mr. Chairman and Members of the Subcommittee, on behalf of the Trustees of the Central States, Southeast and Southwest Areas Pension Fund (hereinafter referred to as the "Fund")*, I am pleased to have this opportunity to submit comments on S. 1678, introduced by Chairman Orrin Hatch, which would amend ERISA to facilitate private pension plan investment in residential mortgages.

Residential mortgages present secure and stable long-term investment opportunities with typically high yields. On their merits, they may constitute prudent and attractive investments for pension plans.

However, the ability of plans to make investments in real property is severely circumscribed by the prohibited transactions provisions of ERISA. These provisions forbid plan fiduciaries from engaging in a broad range of transactions with "parties-in-interest."

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* The Trustees also intend that any of their comments and recommendations herein also apply, where applicable, to the Central States, Southeast and Southwest Areas Health and Welfare Fund.

As defined in Section 3(14) of ERISA, the term "party in interest" includes employers contributing to the plan, their employees, financial institutions which have had dealings with the plan, and other persons and entities. Its sweep is broad. The prohibition applies even where the transaction would clearly be in the best interests of plan participants and conducted at arm's length.

ERISA authorizes the Department of Labor to grant class or specific exemptions to the prohibition which would otherwise exist against dealings with "parties-in-interest." The Fund, however, has found that, in practice, the procedures are onerous, expensive and agonizingly slow.

The current problems associated with obtaining relief through the exemption process have caused plan fiduciaries to ignore a wide variety of potential plan investments which might arguably run afoul of the prohibited transactions provisions, despite the relative financial attractiveness which such investments might otherwise possess. This necessary reaction to the present ERISA rules contravenes ERISA's fundamental policy of promoting prudent and sustained growth in the nation's private pension plans.

It is for these reasons that the Fund welcomes the carefully crafted legislative response reflected in S. 1678 which provides that a plan's investment in a residential mortgage would not violate ERISA's "prudent man" or prohibited transaction rules if the investment satisfies the following three tests:

(1) the plan document must specifically authorize investments in residential mortgages,

(2) the security provided to the plan must be adequate, and

(3) the interest rate on the loan must be reasonable, judged by comparing such rate with the average net yields on plan investments, over a prior specified period, or with prevailing investment standards.

This legislation would facilitate appropriate plan investments and thus strengthen the stability and vitality of private pension plans, upon which so many participants and beneficiaries depend. At the same time, we would expect S. 1678 to infuse the seriously depressed U. S. housing industry, which has been adversely affected by high interest rates and the recession, with billions of dollars of investment capital.

President Reagan announ[illegible]ember 3, 1981 that the Labor Department would propose a class exemption from the prohibited transactions provisions of ERISA to allow plans to make or purchase mortgages for new single-family residential dwelling units. We welcome this action which, as the President noted, will "unlock important new doors to prudent investment in the housing market."

However, the scope of the Department of Labor's proposed exemption is narrower than that of S. 1678 and we believe that certain features contained in the bill make it a preferable approach.

The Department of Labor's proposed exemption as well as S. 1678 provide a plan investment which meets their respective standards will be exempted, under Section 408, from the prohibited transactions restrictions set out in Section 406(a).

However, under S. 1678, a plan fiduciary whose investment satisfies the bill's tests would presumptively meet the fiduciary requirements under Section 404(a)(1)(A),(B), and (C) which require that the fiduciary's actions be for the exclusive benefit of plan participants and beneficiaries; that his actions on behalf of the plan be prudent; and that he adequately diversify plan investments. The Department of Labor's proposed exemption contains no such presumption of compliance with the ERISA Section 404(a)(1) requirements.

The proposed statutory exemption would alleviate fiduciary fears that a plan investment in residential mortgages may be collaterally attacked as a violation of Section 404's fiduciary duties, nothwithstanding that the investment satisfies the criteria established in the Department's proposed exemption. Since the Department of Labor's proposal would not provide as much flexibility and assurance to plan trustees and investment managers in their residential mortgage investment decisions, we prefer the provisions contained in the bill.

Mr. Chairman, this concludes our prepared statement. The Trustees and I greatly appreciate the opportunity to submit it for the record and wish to commend the Subcommittee for its important initiative in this area.

AMERICAN
LAND TITLE
ASSOCIATION

1828 L Street, NW
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FEB 18

February 17, 1982

The Honorable Donald L. Nickles
Chairman
Subcommittee on Labor
Committee on Labor & Human Resources
4230 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

The American Land Title Association (ALTA)* wishes to take this opportunity to expres[redacted] that would amend the Employee [redacted] Income Security Act of 1974. The bill would amend ERISA to provide pension funds simplified and less burdensome standards for investments in residential mortgages.

ALTA supports the proposal since it will provide an additional source of housing credit. Now, more than ever, housing needs a stable and adequate flow of mortgage money to increase the productivity of the housing sector.

Due to the depressed state of the housing market, the title insurance industry lost approximately $70 million in 1981. Other providers of ancillary housing related services are experiencing a similar depression. The time is now for Congress to develop a housing industry recovery blueprint that will provide immediate and long term relief.

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*ALTA is the national trade association of the land title industry. The Association has approximately 2,200 members nationwide. Members include land title insurers, title insurance agents, abstractors and associate members. The principal function of the land title industry is to promote the safe and efficient transfer of real estate, including residential and commercial transactions.

McAuliffe, Jr., *Executive Vice President* • Gary L. Garrity, *Vice President - Public Affairs* • Mark E. Winter, *Vice President - Government Relations* • Richard W. McCarthy, *Director of Research*
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One of the most important facets of such a program should be to increase the availability of mortgage money. New financial intermediaries will have to be tapped to provide this infusion. Supplying a greater volume of funds for residential mortgages should help considerably to moderate the price of those funds, reduce the fluctuation in their supply and stabilize the demand for the product. Pension funds are a prime candidate to provide the necessary new source of mortgage credit.

ERISA CONSTRAINTS

However, the present ERISA law contains a number of constraints that affect a pension fund's ability to invest in residential or other mortgages. The two most onerous constraints are:

... The Prudent Man Rule. These rules require that the investment be prudent, that sufficient liquidity be maintained to pay benefits when due and that the investments be sufficiently diversified to protect against major losses. The prudent man rule applies to all pension fund investments.

... The Prohibited Transaction Rules of ERISA. ERISA generally prohibits dealings between pension funds and related parties, even if the transaction is fair and at arm's length. The prohibited transaction rule applies even if the transaction is advantageous to the pension fund.

Based on these present ERISA constraints, if a pension fund wishes to invest in residential mortgages, the fund must be certain that it does not deal with any related parties in placing the loan. This can be extremely difficult since the possibility of placing the loan either through or with a related party is very probable. For example, if the pension fund uses a savings and loan association or another financial mortgage intermediary to place the loans, that financial institution may be considered a service provider and consequently the financial institution itself would become a related party. Therefore, any fees paid to that service provider would constitute a prohibited transaction.

S.1678 would eliminate the ERISA constraints that have unreasonably restricted the ability of pension funds to invest in residential mortgages. Specifically, S.1678 would eliminate the prohibited transaction restrictions and quantify the application of the prudent man rule for investments by pension funds in mortgage investments.

CONCLUSION

ALTA strongly supports the prompt adoption of S.1678. The problems of the housing industry, its affiliate suppliers and customer groups would be eased and the interest of the pension funds would be well served by the adoption of S.1678. Residential mortgage investments by pension funds are stable, secure, long-term, high yield investments. It is now time for Congress to show its support for a prompt housing recovery through the adoption of S.1678. Not only will the housing sector benefit from an infusion of pension fund capital, but also a whole variety of real estate related industries which also are suffering a great deal as a result of the dramatic decline of homebuilding in this country.

Thank you for your consideration on this important matter. Please include this letter as part of the hearing record.

Sincerely,

Fred B. Fromhold

Fred B. Fromhold
President
ALTA

FBF:dlh
cc: Members of the Senate Subcommittee on Labor

Senator NICKLES. This meeting is adjourned.

[Whereupon, at 3:45 p.m., the subcommittee adjourned, subject to the call of the Chair.]

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